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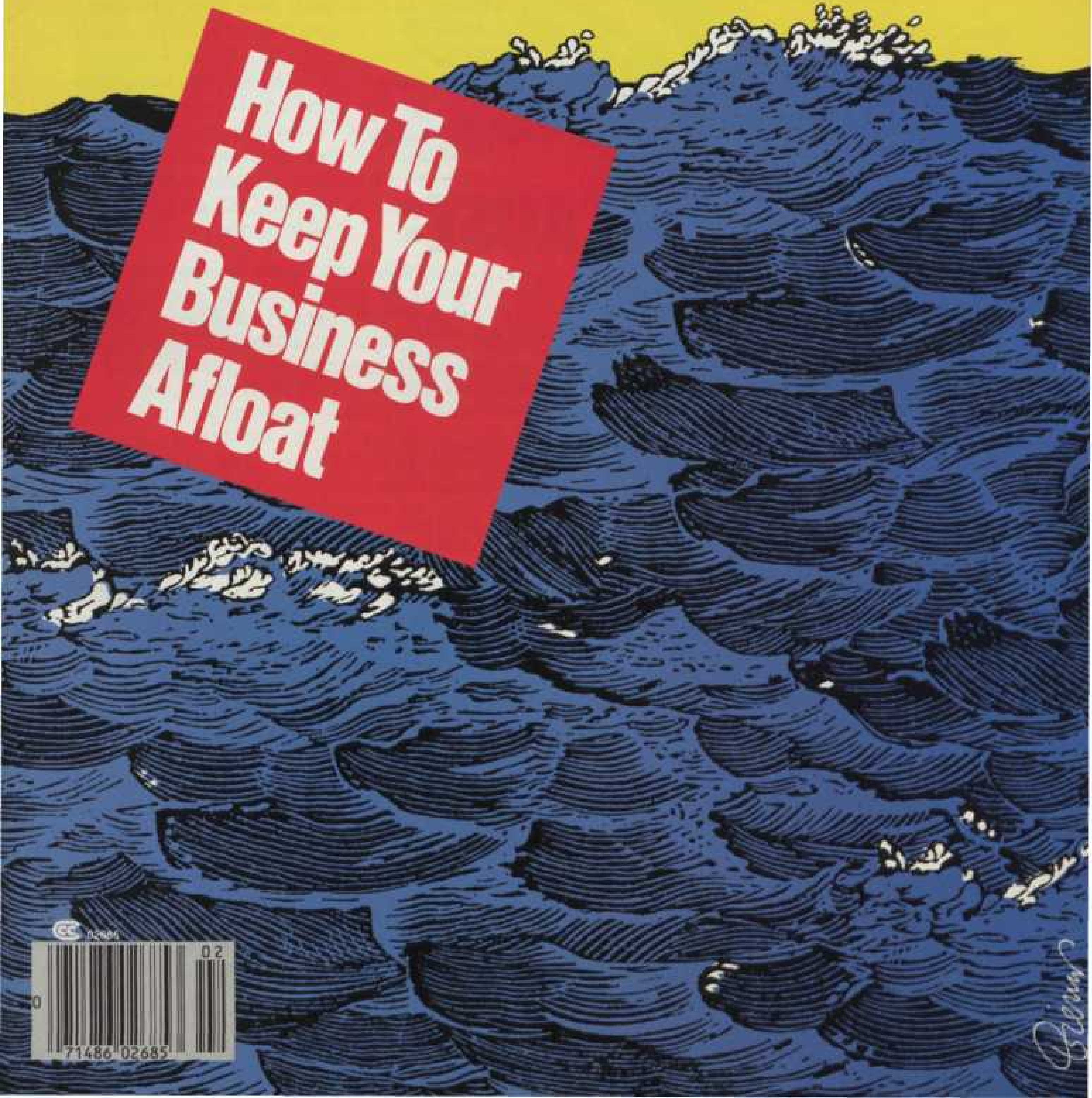

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MANAGING YOUR BUSINESS

When his company got into trouble, Thermwood Corporation's CEO Kenneth J. Susnjara took the unusual step of becoming a distributor of his Dale, Ind., firm's product. Looking at the problems from the outside made all the difference. (Cover Story, Page 16)

PHOTO: DAVE REPP

Cover Design: Vignelli Associates

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DEPARTMENTS

Betsy Noble's Custom Jockeys' Apparel makes silks—colorful and distinctive riding outfits—for jockeys like Bret Herron. (Making It, Page 65)

PHOTO: LEN KAUFMAN

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COMMENTARY

Losing The Future To The Past

By Mark Pastin

The information revolution and the entrepreneurial revolution are widely viewed as two faces of the same phenomenon. However, the information revolution may prove to be something that knocks opportunity-seizing down for the count.

Entrepreneurism has benefited from the information revolution, of course, in the short run.

Broad and rapid industrial changes open markets for new products. Corporate bureaucrats are slow to recognize those markets—and reluctant to enter them without proven product demand. Entrepreneurs, on the other hand, gamble on what they see as trends—thereby helping what they see to become reality.

And so it has been in the information revolution—from Apple's personal computers to MicroPro's PC software.

The information revolution has also helped existing enterprises launched by entrepreneurs. A modest computer system can drastically reduce businesses' overhead by assuming many bookkeeping, secretarial and other office functions, for example.

But the information revolution threatens the lifeblood of entrepreneurism—the process of trial and error.

Why did the West and Southwest historically serve as havens for entrepreneurs? Many explanations are proffered, but the truth is simple. Entrepreneurs tend to fail the first time they start a business, and word gets out that they blow other people's money. So entrepreneurs often moved westward and westward and westward, leaving the bad news behind until trial and error yielded profits.

This process of learning through failure, of getting a second chance, became part of the very essence of American capitalism.

Capitalism is efficient because businesses that don't meet needs can fail. Unlike the people who run East European economies, company managers are not government minions who can keep the factory open no matter how poorly it performs.

Guest columnist Mark Pastin is professor of management and director of the Center for Ethics at Arizona State University.

More important, failure is not final. Under capitalism, those who have ideas and take risks are offered the chance to learn from failure. Failure, once its lessons have been learned, becomes the spur to success.

Thanks to the information revolution, you can say goodbye to the second chance. The computer is less forgiving than the Pony Express, as well as more efficient. Corporate performance appraisal, which promptly punishes failure but slowly and partially rewards success, drives entrepreneurs into the hands of bankers and venture capitalists. And financial recordkeeping will make those hands tight fists.

"The information revolution threatens the lifeblood of entrepreneurism."

Would you give money to someone who blew the investors' money last time round the track, if you were a loan officer at Grind It Out National Bank?

The venture capitalists? They too want to bet on records of success and "mature management"—read: "those who kept their heads low in corporate bureaucracies"—rather than some Steve Jobs-like garage inventor.

Says the information revolution: If you want to try bold ideas, start with small projects and build a record of success. Keep your head low until the time is right.

The answer to this problem may seem obvious: Devise rules that set maximum lengths of time in which financial records can be divulged. We have laws limiting the time that credit companies can retain negative information about consumers. Why not pass laws limiting the memory of other financial reporting?

But who will devise and enforce these rules? If federal or state governments took up the cause, I would worry. If governments can tell private institutions what they are entitled to remember about their finances and what they can reveal to other private institutions, it would be one more liberty-threatening type of government intrusion.

There are more difficulties. Who would lobby for such laws—the Association of Bankrupt Entrepreneurs? And don't those who have long-term records of success have a right to keep their records alive?

The likely outcome? The information revolution will continue to serve as handmaiden to a society hell-bent on judging people by credential and record, rather than by their ideas and willingness to take risks. It will accomplish what George Gilder calls the goal of left-wing elitists—capitalism without capitalists.

It is a revolution that is profoundly changing the ethics of capitalism. The change is away from the principle of judging people by what they have to offer today and tomorrow—of being fair, of giving them a second chance to prove themselves.

In the information revolution, people are being judged by what they did yesterday and ever farther into the past. They are not being judged on ability but on length of resumé and absence of missteps.

As is the case with many changes, we don't really see what the changes mean until they are irreversible.

Enjoy the incredible fruits of the current entrepreneurial boom. You probably won't get a second chance. NB

COMMENTARY

Letters

Huzzahs And Hisses

I would like to applaud the commonsense advice of guest columnist Daniel R. DeNicola ["Liberal Arts And Business," December] that a strong liberal arts background is the key to business success.

Let's face it, how many college entrants really know what major they wish to follow, or what they really want to do with their lives beyond college?

I majored in economics with a minor in political science and indulged heavily in such courses as English, arts appreciation, history and geography. Upon graduation these courses stood me in good stead for my career in business and government.

DeNicola is, of course, correct in that liberal arts graduates often obtain lower entry-level jobs in some industries, but once in they are limited only by their industry and resolve. He is right again that a liberal education does not end with the degree.

Theodore L. Humes
Phoenix

The assertion that "the best preparation for a career in business is a strong liberal arts education" lacks credibility.

Certainly there are liberal arts programs, usually based on graduate degrees, that prepare students for professional careers. However, students in other programs are also well prepared. Does DeNicola pretend that a degree in philosophy would make accountants, engineers and computer programers ready for the work world?

It may have been true in the past that liberal arts graduates were more successful in business—one reason being that liberal arts programs attracted the brightest students.

But in the last decade, the liberal arts have drawn those with the lowest SAT scores, while business and engineering programs now enroll the best prepared students.

More important, liberal arts programs are often taught by faculty overtly hostile to private enterprise. How can students instructed by those with little or no knowledge of the real world and a disdain for anything perceived as practical be well prepared for a career in business?

David A. Martin
John Wiley Jones School of Business
State University College of Arts and Science
Geneseo, N.Y.

One cannot properly and effectively conduct business by calling upon Socrates to analyze a balance sheet and cannot use History 101 to make decisions about profitability.

An easy liberal arts curriculum only turns out philosophical theoreticians

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with little to offer the business world, except interference with it. In fact, as one who majored and obtained honors in mechanical engineering and business administration, I resent those allowed to follow a cushy liberal arts curriculum and who are given the same degree as myself.
Richard A. Katzman
New Cumberland, Pa.

Deductible Renovations

Recently your magazine published a story on the newly enacted tax reform law ["Welcome To Tax Reform," November].

Your readers might be interested in more details regarding Section 190, which permits businesses to deduct up to $35,000 annually for costs associated with making structural renovations to provide accessibility to handicapped patrons.

Such renovations can include wider doorways, parking spaces, ramps and curb cuts to accommodate those using wheelchairs, canes and walkers. Business vehicles used to transport customers—such as hotel limousines—also would qualify if specially outfitted for the handicapped.

Already many merchants and medical professionals have taken advantage of the tax benefits of Section 190—and improved the outward appearances of their business sites.
R. Jack Powell
Executive Director
Paralyzed Veterans of America
Washington

All Our Children

Congratulations on an outstanding report concerning business day care needs ["Child Care: Your Baby?" December].

This issue was brought to our chamber committees two years ago when employers recognized it as both a public and a private sector problem. The result? The chamber successfully developed a new program that allows companies that provide day care or that join consortiums to completely depreciate related capital expenditures over just two years.
Dan Cavanagh
Vice President, Governmental Affairs
Tucson Metropolitan Chamber of Commerce
Tucson, Ariz.

The key point came through very clearly—employer assistance with child care expenses is emerging as a vital employee benefit, one easily provided by employers of all sizes and from which everyone benefits. From our perspective, yours is perhaps the most comprehensive and encouraging article we have seen, especially for small business owners.
Carole M. Rogin
Executive Director
National Association for Child Care Management
Washington

I hope your outstanding cover story encourages day care centers to survive and causes corporate officials, consider-

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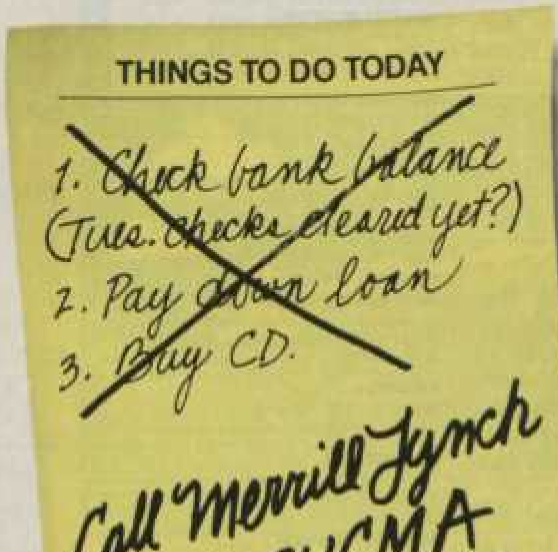

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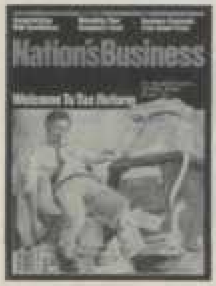
COMMENTARY

Letters



ing the needs of their many employees in two-career families, to support them.
Lee R. Munsick
Dover, N.J.

Illustrative Angst

I am writing to let you know how much I admired the artist's work on the cover of the November issue. The taxpayer at the desk in your illustration closely resembles my boss. We in the office loved it!
Christina Bowles
Ruston, La.

Charitable Newcomer

Your article about Higher Horizons Foundation, Inc., and James Riley [Business Outlook, November], while interesting, was hardly news to us, since we started our nonprofit gifts-in-kind association six years before his.

The National Association for the Exchange of Industrial Resources, celebrating its 10th year, has outgrown four warehouses and has nearly 7,000 school and nonprofit members. Last year we collected $41 million in excess inventory from American industry and distributed it to our members.
Norbert C. Smith
President
NAEIR
Galesburg, Ill.

Selling Computers

I read with interest the first installment of your series "Computerizing With Confidence" [November].

The article seems to give a bad rap to microcomputer systems' abilities to handle high volume retail applications.

My company sells a system that is currently installed in a variety of retail environments, including home improvement centers, apparel, liquor, hardware, music and even paint stores (such as the one discussed in your article). Some of these are high volume businesses with as many as 12 stations operating in a network environment. We have never had our system removed because it could not do the job.
Robert C. Crichlow
Dumfries, Va.

December's "Computerizing With Confidence" was well done with one important exception: It was decidedly IBM-oriented.

I feel compelled to point out that it has been Apple's Macintosh that has set the personal computing world on its ear.

Not only has the "Mac" opened a whole new era in personal computing because of its user friendliness, but almost anyone who has used this incredible little box will tell you of its delights.
Derek Van Artsdalen
San Antonio

Floating Like A Rock

In "Managing Your Company's Cash" [November], you suggest using "bank float" to maximize the geographical difference between an account and the bank. A business that attempted this could be in for a shock as well as some overdraft charges.

Recently a bank officer told me that, with the electronic draft system, it was very possible for a check cashed in Chicago in the morning to be charged against an account in California that same afternoon.
Nile Greenhalgh
Mundelein, Ill.

Liable To Continue

I find it incredible that Philip J. Hermann would contend that lawyers will "realize that litigation adversely affects them financially" [Small Business Report, December]. The more litigation, the more lawyers involved, the more money earned. And the longer the case drags on, the larger their fees.

Liability insurance premiums will continue to increase until such time as we follow the rest of the world by outlawing contingency fees and requiring the plaintiff to pay all of the defendant's costs if the suit is unsuccessful.
S.S. Steele
Mobile, Ala.

Liability insurance is definitely out of control. If premiums continue to increase, it will knock the small business person out of the competition with foreign companies.
Bill Schene
San Luis Obispo, Calif.

And The Winner Is . . .

"Forecasts From Small Firms" [November], quotes one CEO as saying, "The people who make decisions should get down in the trenches." One way of getting congressmen "down in" would be to select them by lottery, reimbursing them for their single term of service on the basis of prior year's income.
M.H. Needham
Bishop, Calif.

Nation's Business

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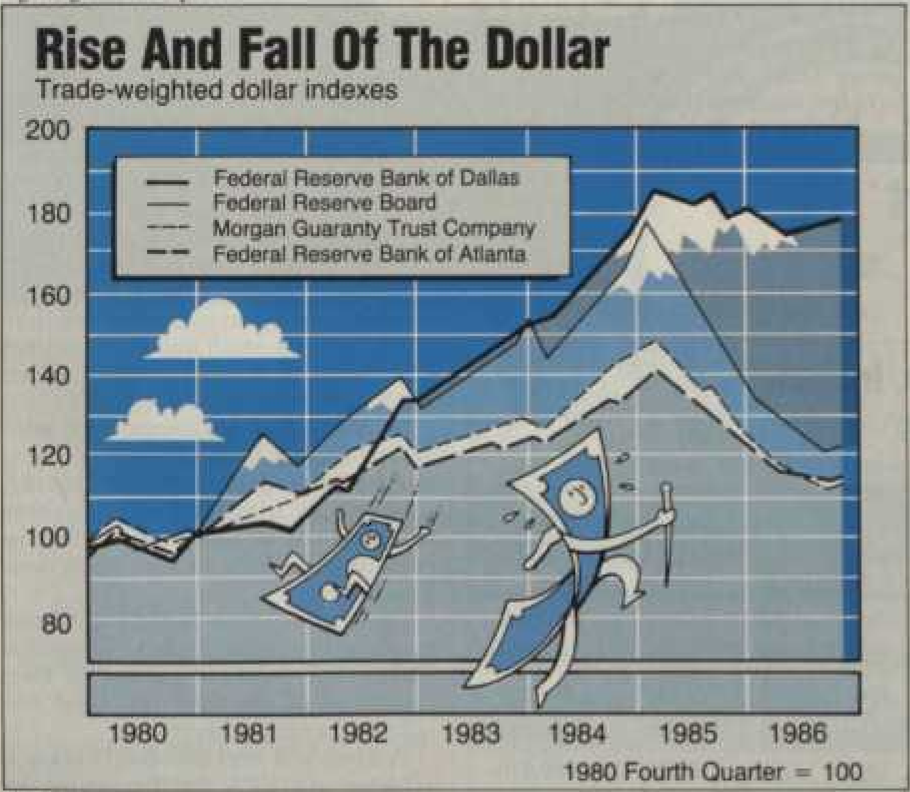
The Nation's Business

Business Outlook

By Roger Thompson



Which Index Do You Read?

Most economists expect the U.S. merchandise trade deficit will begin to shrink this year, chiefly because of the two-year decline in the value of the dollar. If they are correct, manufacturers will boost their exports of newly competitive American products.

But any shrinkage in the deficit is likely to be modest, in part because the dollar really has not declined much or at all in relation to the currencies of such key trading partners as Canada, Mexico, South Korea and Taiwan.

This does not show up on the most widely quoted dollar index, the one reported by the Federal Reserve Board. The Fed has the dollar declining 40 percent since its peak in February, 1985—after rising 61 percent from a trough in late 1980. The problem is that the index includes currencies from only 10 nations—Japan, Canada and eight in Western Europe. Most of the depreciation has been against the German mark and the Japanese yen.

Many economists maintain that the Fed's index is outdated because it is based on trading patterns a decade old. It places three quarters of its emphasis on European currencies, "yet Europe constitutes only one fourth of U.S. trade," says Jeffrey A. Rosensweig, an economist with the Federal Reserve Bank of Atlanta.

Rosensweig has developed his own index that more nearly reflects current U.S. trading patterns, which have shifted toward Far Eastern nations in recent years. Their share of total U.S. trade rose from 21 percent in the mid-1970s to over 32 percent in 1985—nearly half of which went to nations other than Japan.

Accordingly, Rosensweig's index includes currencies of six Far Eastern countries along with Australia, Canada and Saudi Arabia, plus nine from Europe—for a total of 18. On this index, the dollar has fallen only 22 percent from its peak, after rising 34 percent since 1980. The main reason the drop is less dramatic than that reported by the Fed is that the dollar has not gone down in value in relation to the currencies of the Oriental countries, with the exception of Japan.

Of particular concern are Hong Kong, Singapore, South Korea and Taiwan, collectively known as the NICs—newly industrializing countries.

The NICs peg their currencies to the dollar, effectively devaluing their money in step with the dollar's decline. The United States racked up a trade deficit with the NICs of more than $29 billion in 1986, prompting the Reagan administration to pressure Korea and Taiwan to revalue their currencies upward.

NICs are not included in an index reported by Morgan Guaranty Trust Company, which, like the Fed, tracks only currencies of developed nations. The Morgan index of 15 currencies includes the same 10 counted by the Fed, plus Australia and four additional European nations. It shows a dollar decline of 29 percent, on the heels of a 40 percent rise.

The latest entry in the dollar index field was developed by W. Michael Cox, an economist at the Federal Reserve Bank of Dallas. His is the only index to include every country that trades with the United States—131 in all. Because most developing countries' currencies have not declined in relation to the dollar, Cox's index has fallen only 3 percent in the past two years, a fraction of the 61 percent rise since 1980. He is not optimistic about much improvement in the U.S. trade deficit.

Regardless of the index they use, economists applaud the Reagan administration's efforts to bring down the value of the dollar. Many see room for another 10 to 20 percent decline in relation to major currencies. But they note that the trade deficit will shrink slowly in years to come unless additional measures are taken.

Chief among these measures is bringing federal spending under control.

Many economists maintain that borrowing from abroad to finance the federal deficit drove up the dollar's value in the early 1980s.

Says Lawrence B. Krause, a University of California economist: "It is not what other countries did or did not do, but what we did to ourselves that caused the U.S. trade deficit."

Family Buying Power Heads Up

The purchasing power of an average one-earner family of four will increase in 1987 for the sixth consecutive year, says a report by the Tax Foundation, a nonprofit Washington-based research group. That is good news for the economy, which needs healthy consumer spending to maintain steady growth.

After-tax, inflation adjusted income has risen 2 percent a year since 1981 and will continue on a similar path this year, says the report.

Even so, the prototypical one-earner family had $986 less buying power in 1986 than a decade earlier. From 1976 to 1981, inflation and rising federal taxes slashed 13 percent from the funds the family could use for purchases. Lower taxes and inflation since then have not made up the difference. NB

Small Business Report

By Roger Thompson

Top 10 States With Asian, Indian And Hispanic Businesses

(Firms And Sales—In Thousands of Dollars—In 1982)

Source: U.S. Census Bureau

Asian-American And American Indian			Hispanic		
State	Firms	Sales	State	Firms	Sales
Calif.	95,982	$6,715,728	Ariz.	6,602	$289,405
Fla.	5,827	334,660	Calif.	74,998	4,218,913
Hawaii	29,040	2,419,436	Fla.	33,516	2,757,332
Ill.	9,417	554,298	Ill.	5,218	356,787
Md.	4,600	275,222	La.	2,172	200,810
N. J.	5,605	328,226	N. J.	6,466	464,350
N. Y.	19,003	1,121,439	N. M.	9,354	515,922
Pa.	4,345	252,427	N. Y.	14,477	1,018,280
Tex.	20,867	1,111,040	Tex.	61,540	3,435,088
Wash.	5,838	365,639	Wash.	1,876	67,870

Minority Entrepreneurs

Asian-American and American Indian businesses generated $17.9 billion in sales in 1982, compared with $15 billion taken in by slightly fewer Hispanic-owned firms. The figures come from two new Census Bureau reports, based on a business survey conducted every five years.

Service and retail businesses comprised 70 percent of the 255,642 Asian-American and American Indian firms and 63 percent of the 248,141 Hispanic companies. More than 9 out of 10 firms in both groups were sole proprietorships. Of the former group, 1 in 5 had paid employees; of the latter, 1 in 6.

Two thirds of the Asian-American and American Indian firms were located in five states: California, Hawaii, Texas, New York and Illinois. The groups were lumped together, along with other small minorities, because they were too small for separate surveys.

Three quarters of Hispanic businesses, with 80 percent of gross receipts, were in California, Texas, Florida, New York and New Mexico.

An earlier Census Bureau report on black-owned businesses reported 339,239 firms in 1982 with receipts of $12.4 billion.

Taking The Liability Insurance Offensive

Independent insurance agent James A. Sullivan set out two years ago to solve a problem: how to provide affordable professional liability insurance to certified public accountants in his home state of Idaho.

The solution, he decided, was for an insurer to provide coverage just for CPAs, without taking on risks for other occupations as well. That led him to launch the Professional Services Corporation, a Boise-based insurance company designed to meet the needs of CPAs nationwide. The firm's first line of coverage, which hit the market in January, is liability insurance. Health, life and other lines of insurance will follow.

"Over the past few years, premiums for accountants' professional liability insurance have risen more than 1,000 percent, causing an estimated one third of the nation's small and medium-sized CPA firms to operate without coverage," says Sullivan.

He hopes that his company, in addition to offering broader and less expensive coverage than is currently available, will be a model for professional organizations to follow in creating insurance companies under new federal legislation.

The Liability Risk Retention Amendments of 1986 make it easier for professionals and business groups to form captive companies that will cover their liability insurance needs.

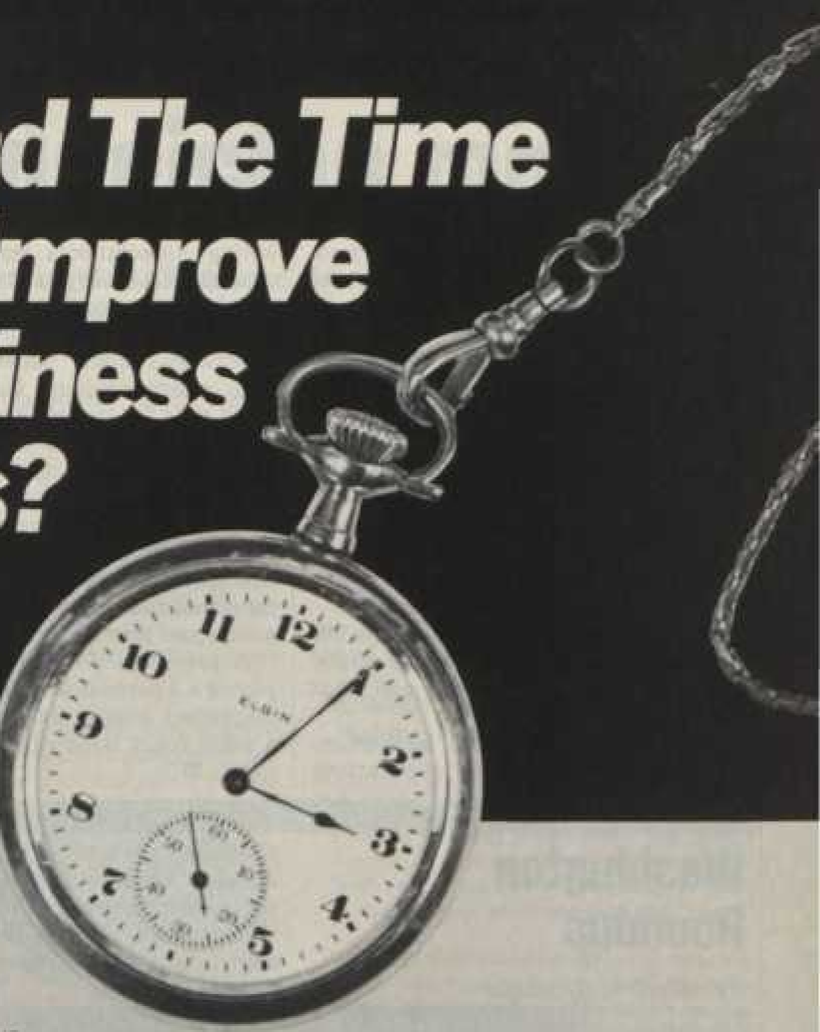
Professional Services Corporation is offering its CPA liability coverage through a Delaware-based company, which it established, called the CPA Risk Retention Group Corporation. C-PAC-O, as it is known, is the first professional liability insurance company licensed under the 1986 federal law, Delaware Insurance Commissioner David Levinson says.

The law "has planted the seed of a revolution in liability insurance," says Michael Joye, a C-PAC-O lawyer with the New York firm of LeBoeuf, Lamb, Leiby & MacRae. "The likely result is formation of a large number of insurance companies owned by those insured."

Telemarketing On The Defensive

Telemarketing's image took it on the chin on election eve in November when a GOP computer would not stop calling the second floor of a suburban Dallas hospital. Patients repeatedly heard

Can You Find The Time To Improve Your Business Skills?



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Ronald Reagan's get-out-the-vote pitch until a switching error was corrected.

Computer-delivered recorded messages usually pitch products, not politicians. But even when calling proceeds flawlessly, few consumers warm to an unsolicited recorded voice. Not surprisingly, marketing by computer is coming under increasing state regulation.

Virginia last year passed a law banning recorded messages for initial sales calls. Georgia and Washington State require messages to carry a phone number that consumers may use to contact the company placing the call. Texas limits calls to certain hours of the day.

Telemarketing of all kinds reaps $90 billion a year in sales for the 80,000 companies, many of them small, that use it.

Most consumer-oriented telemarketing companies welcome regulations that correct abuses, says Joseph Pannullo, head of the American Telemarketing Association's legislative action council. But he says some state legislators have tried to go too far.

The biggest threat is "asterisk" laws that would allow consumers to star their phone directory listings to avoid "cold calls." Asterisk laws were considered in more than a dozen states last year, but none passed. Pannullo expects similar bills to resurface this year. Asterisk laws are unworkable, he says, because telemarketers do not work with phone books but with computerized lists containing thousands of names and numbers.

A law passed in Illinois last year placed a 5 percent surcharge on all telemarketing equipment and service. But a state court later ruled it unconstitutional. NB

Washington Roundup

Congress' preoccupation with the Iranian arms controversy may produce a session so torpid that the Chicago Bears' William Perry will seem a sprinter by comparison.

By Albert G. Holzinger

PHOTO: RICHARD DERK

Slower Than A Refrigerator?

Newly elected Congresses are notoriously slow starters, but the 100th Congress may make mammoth Chicago Bears lineman William "Refrigerator" Perry seem like an Olympic sprinter.

What prompts this lightfooted comparison is the uproar over the Reagan administration's revelation that arms were shipped covertly to Iran last year and that some profits from the sale were used to aid contra rebels in Nicaragua.

Washington, whether official or nonofficial, loves controversies, and—more than any other part of the country—it has been abuzz with the questions, "Who knew what?" and "When did they know it?"

Even prompt hearings by the Senate and House Intelligence committees are unlikely to restore a business-as-usual atmosphere in the Capitol anytime soon.

Unfortunately for business, one matter likely to lose its high place on the agenda is making the tough choices required to meet the Gramm-Rudman-Hollings law's 1988 deficit target of $108 billion.

Also, the President and the business community wanted Congress to reform the budget process itself. Under the process as it now exists, lawmakers were unable to enact even one of the 13 appropriations bills needed to run government during 1987. Instead Congress, just before adjourning, sent Reagan an omnibus $500 billion, 700-page continuing resolution, depriving him of the opportunity to veto any single agency's budget as excessive.

Suggested reforms include biennial budgeting, which proponents say would improve Congress' effectiveness by giving it more time for nonbudget matters; enhanced presidential authority to withhold funds for specific programs authorized by Congress; and—to meet Supreme Court objections—rewriting Gramm-Rudman's provision for automatic fund withholding across the board in the face of high deficits.

On the favorable side for business is likely delay of congressional debate on such employer-opposed proposals as mandatory parental and disability leaves, extension of an expiring unemployment compensation tax increase and required "risk pools" to provide health care coverage to poor insurance risks.

Delays on these measures, which were shunned by the last Congress, will give business valuable lobbying time.

Taxing Regulations

Congress' work on tax reform is over, but the Internal Revenue Service's labors have just begun.

All new tax laws are chock full of ambiguities and vague definitions, and a law as sweeping as the Tax Reform Act of 1986 is certainly no exception.

So the IRS has asked business groups, including the U.S. Chamber of Commerce, to help it answer such questions as "What constitutes book income?" (Book income must be determined when computing the new alternative minimum tax.)

Answers to these questions are vital to corporate and individual taxpayers because they will partially determine net taxable income. NB

MANAGING YOUR BUSINESS

Spiels On Wheels

A salad company with a limited advertising budget takes its message to the streets.

By Nancy L. Croft

Laura Gault, a Fairfax, Va., commuter, thought she was seeing things one morning on her drive to work. An 8-foot-tall tomato rolled past, and a truck driver waved hello from his window. "It was bizarre," recalls Gault. "I remember seeing the words 'Salad Singles,' and I think the tomato was stuffed with tuna or chicken salad."

That was the sort of reaction Richard Kent was hoping for. The brilliantly colored, billboard-like ad on his company's tractor-trailers could herald a new trend in outdoor advertising.

Kent is president of the Orval Kent Food Company, a Wheeling, Ill., firm that supplies delicatessens in major cities with bulk containers of 100 varieties of ready-made salads, including potato, pasta and chicken. Served from deli bins, the salads appear to have been made on the premises.

A couple of years ago, Kent wanted to improve awareness of the first product bearing the firm name. Packaged in single-serving containers, Orval Kent Salad Singles were distributed to supermarkets in 11 cities. But like many new products without big budget marketing support, they usually were not on shoppers' grocery lists.

Kent's solution came from an unexpected source: the printing company that had embellished his trucks with the company logo. Modagrafics, of Rolling Meadows, Ill., sent him a report on an American Trucking Associations survey showing that 10.1 million people see the average tractor-trailer in a year. And 91 percent of survey respondents said they notice trucks displaying words or pictures.

"I didn't need too big a calculator to figure out that if you put a few trucks with your ad on the road, you'd reach a lot of people," says Kent. Naturally, the bigger the ad, the bigger the impression it would make, he reasoned.

In fact, he thought, why not a whole side of a truck? "Since we had limited ad dollars to spend, we had to do something different to get attention."

Working with a 3M process that would make a giant photographic-quality billboard possible, Modagrafics produced king-size silk screens from a color photographic ad created by the Orval Kent Company's ad agency and printed them on adhesive-backed vinyl sheets. It also sent application teams to the company's distribution centers to turn mundane tractor-trailers into 9-foot-high by 48-foot-long mobile billboards.

PHOTOS: RICHARD DERK

That is how Laura Gault came to be surprised by a giant tomato.

Most of the Orval Kent Company's ad space is leased. Modografics scouts target markets for trucking companies that are willing to lease the sides of plain-sided tractor-trailers. The trucks may be hauling anything from light bulbs to pantyhose. Orval Kent offers trucking firms $1,200 for the right to advertise on 25 vehicles for three years.

Including the printing and application costs of the decals and the leasing fees, Richard Kent estimates his company pays 21 cents for every 1,000 people who see its ads.

"People who live in markets where our product isn't yet distributed have called to say they have seen our trucks passing through, and they want to know where they can get Salad Singles," says Kent.

Does motorists' craning of necks threaten to cause highway pile-ups? The Transportation Department apparently does not think so. Bureau of Motor Carrier Safety rules allow full-scale ads on a truck as long as they do not interfere with its exterior lights, are not obscene and do not create an optical illusion—such as stripes or circles making the truck seem smaller.

Other companies also are profiting from spiels on wheels. James Foley, president of New York-based Prestige Panels, Inc., is giving people in New York, Chicago, Detroit and Washington something to gawk at.

Foley wanted to offer advertisers more outdoor attention in cities like New York and Washington. "That's where advertisers want to be—where the eyeballs are," he says.

In February, 1985, Prestige Panels started rolling out 10-foot-high by 22-foot-long panels for specially designed flatbed trucks. Foley, mum about the leasing cost of one of his mobile billboards, says he gets a lot of repeat business.

Woman's Day, which frequently leases the company's panels in New York to attract advertisers, has been a client from the start. Three days after the magazine's first panel made its Manhattan rounds, Foley received a phone call from a *Woman's Day* ad representative.

"He said, 'This is terrific!' " recalls Foley. "He said the magazine had never gotten that much response from ad agencies and advertisers."

That is king-sized advertising on a roll. NB

COVER STORY

Keeping Your Business Afloat

By Nancy L. Croft

Kenneth J. Susnjara, chairman and president of Thermwood Corporation, Dale, Ind., left the executive suite to become a distributor for his own company as part of his campaign to turn the robotics firm around. In the field, he spotted marketing weaknesses and later implemented changes that helped save the company that he founded.

PHOTO: DAVE REPP

As a distributor of Thermwood Corporation's products, Kenneth J. Susnjara had a grass-roots view of the serious problems causing his company's financial crisis.

These problems had been caused by excessively optimistic expectations for sales of a major new product, a robotic paint sprayer, which had been added to the company's line of manufacturing equipment.

From his perspective on the firing line, Susnjara could see that the company had appointed too many distributors, that a policy of forcing them to buy a demonstration paint sprayer was counterproductive, and that communications and relations between the home office and the distribution force were generally poor.

He prepared an analysis for the company's founder, chairman and president that led to the company's return to profitability. The chief executive—and chief strategist for the company's turnaround—happens to be the same Kenneth J. Susnjara.

He had left the top executive post in the Dale, Ind., company he founded 18 years ago for a temporary stint in the ranks as part of his effort to find ways to turn it around.

"We had invested a lot of money on a horse that never got out of the starting gate," Susnjara, now 39, recalls of the company's all-out drive to become a major producer of computerized paint sprayers. "We spent a huge amount of money on a market that never really developed."

It became apparent, he continues, that "we'd no longer be in business if we continued on this path, and that we would have to make some fairly drastic changes in how things were being run."

One of the drastic steps he took was turning over the leadership of the company to a member of its board of directors while he became a distributor for three months. That action, Susnjara says, was "one of the things that helped the most." He says of that experience:

"I began to see the company that I had founded in a totally different light. When I was the chief executive, the things the company did appeared to be the right things to do, to be based on sound reasoning. When I became a distributor, many of those same things looked ill-considered, and some of them actually looked foolish. It was very apparent what was wrong with the company when you viewed it from the outside. It was not apparent at all from the inside."

For example, he recalls, the requirement that all distributors buy a demon-

Spotting danger signals in time to take corrective action is the key to business survival. Here's how you can set up your early-warning system.

stration model costing $50,000 to $75,000 helped company sales, but those distributors then spent too much time trying to sell the demonstrators before they were outdated by later models, regardless of customer preferences.

Changes implemented as a result of his experiences in the front lines played a major role in bringing Thermwood through its crisis.

The elaborate R&D and marketing organizations are gone. The heads of the three operating divisions of the reorganized company had their pay cut in half but were offered performance bonuses enabling them to make two to three times their former salaries. "They didn't have to put up a fancy front and follow all those philosophies we had before," Susnjara says. "They didn't have to do anything other than make money any way they could."

Now, he says, "this thing is going to make it."

Susnjara's aggressive and successful approach to saving his company puts him in that special category of entrepreneurs who have successfully turned back major threats to their businesses by recognizing and responding to the danger signals in time.

The challenge of keeping a business afloat in the face of unanticipated setbacks and problems is one that many small business people will face. Many are not prepared for it. But the experiences of people like Ken Susnjara and other entrepreneurs who have weathered threats to the survival of their businesses, as well as the advice of experts, can help provide the guidance others need to keep in the race.

The threat of business failure is a very real one. The Small Business Administration reports that over half of all new businesses fail within their first four years. If you counted every home-based and sideline business, some experts say, the failure rate grows to nine out of 10.

Management consultant James Sullivan (left) of Excelsior, Minn., says there are "stress points" that growing companies need to be able to recognize and deal with as they move from one level of sales to a higher one.

PHOTO: STEVE WOIT—PICTURE GROUP

But management experts and business people who have been through it stress that entrepreneurs in financial difficulty should not think that bankruptcy is the easy way out.

Stephen Cox, 38, and his wife, Avis Renshaw, 28, of Herndon, Va., underwent a painful lesson on the severe business and personal problems that bankruptcy brings on. Their initial venture, based on a plan to grow fruits and vegetables and sell them through retail stands, failed after a series of classic managerial errors and unanticipated events drove them into both personal and business bankruptcy.

Instead of a thriving enterprise bringing them the financial security and prestige they expected from "being my own boss," they found themselves in an economic and emotional quagmire. Reliance on a government loan that failed to materialize, undercapitalization and a drought that ravaged the first crop were among the factors that forced them into bankruptcy.

"You have to expect to live like paupers," Renshaw says. "The bankruptcy pretty much stripped us of everything. We moved around and lived with friends for a couple of months." At that point, they had an infant daughter and another child on the way. Renshaw recalls: "We couldn't associate with most of the people who loaned us money. It is very hard to face them. You have this feeling that if you buy a box of cookies or something like that, you shouldn't be doing it but should be sending the money to one of the people you owe. It is a very weird feeling."

As a stopgap measure to earn some money to support themselves and their children, the couple started baking pies in a 50-square-foot kitchen, selling a few at a time to the same type of road-

Avis Renshaw and Steven Cox of Herndon, Va., whose first business failed, are running their new pie-baking company with more caution.

PHOTO: T. MICHAEL KEZA

side produce stand they previously operated themselves. Demand for the pies grew, and they established Mom's Apple Pie Company. But the specter of the earlier failure hangs over the new business. Opportunities for growth through expansion of facilities is hampered because the bankruptcy makes lenders wary, Cox and Renshaw report. Much of the present equipment was found in junkyards or bought secondhand. Money to keep it in working condition comes out of operating income, which makes it difficult to achieve a bottom line that would convince lenders to advance money for capital investments. "It's a real Catch-22 situation," Renshaw says.

How do entrepreneurs avoid those and the many other problems stemming from bankruptcy?

Emory Toncré, a leading consultant on small-business management, warns that start-up firms in particular should guard against excessive optimism when it appears the business is going to be a success. Too many business people, he says, think they have reached a safe plateau on which they can stay permanently. But, he says, "a business never stands still. It either goes forward or backward. It never plateaus."

While planning is the most critical aspect of making a success of a business, Toncré says, it is often one of the most ignored considerations. Told they should have a game plan covering the next 18 months, small business people typically respond: "'I'm just a small business person. I don't have to go to all that trouble.'

"But it doesn't make any difference whether the business is being started with \$2,000 or \$1 million," Toncré says. "Survival depends on whether the business has a plan and sticks to it."

In his book, *The Action-step Plan to Avoiding Bankruptcy* (Prentice-Hall, Englewood Cliffs, N.J.), Toncré says, "The most effective planning tool a business owner can use is the cash projection."

He explains: "The most serious consequence of not having a sound cash projection is finding yourself undercapitalized. Most small business owners operate with limited amounts of working capital . . . [that] could be depleted within 90 days. Therefore, cash projections can alert the business owner to the amount of available working capital before it becomes too late to take remedial action."

Another major factor in avoiding bankruptcy, he says, is keeping abreast of the marketplace: "Many established business owners have unintentionally capped the growth of their businesses by accepting the belief that their business has peaked and there is no further need to expand by introducing products or ideas into the marketplace. What these owners fail to understand is that the marketplace is constantly in a state of flux, with ideas and businesses being introduced every day. For today's business owners to ignore the changing marketplace can only spell disaster, especially if competitors are reacting in a positive manner to changes."

Another expert advises small businesses to become aware of specific "stress points" at which the changing size and nature of an enterprise require new perspectives and approaches for it to survive.

James R. Sullivan of Excelsior, Minn., whose consulting firm assists financially troubled companies, offers a paradox in explaining the necessity for such a policy: "Success can put small companies under faster than anything."

He explains: "With a meteoric rise in sales, a company finds itself adding plant capacity to meet sales demand. Then, the owner wakes up one day to find that the company is overleveraged. Money is tied up in the plant and equipment. Gross margins are shrinking. The idea that 'we will make it up on volume' doesn't work.

"When you find you are borrowing your capital, rather than having retained earnings, you are pledging the assets of your company. It becomes kind of a vicious circle. In order to support your debt, you've got to get a higher growth margin by expanding your sales. To do that, you can't raise your prices because you won't get the sales.

"So, management begins to make decisions that lean toward expediency. They say that, if we can just take care of this problem this month, by next month our sales will catch up, and we will be fine. When this doesn't happen, they realize that they made a bad decision. After this happens a couple of times, management loses confidence in its ability to make decisions and paralysis sets in."

One way to avoid such problems, he says, is to watch for the stress points: "I have found that stress points come in terms of size of sales—at \$1 million, \$5 million, \$25 million and \$50 million."

It works this way, Sullivan explains:

"A guy has an idea, and he goes to his brother-in-law and his uncle and borrows enough money to go into business. He writes all the checks and does all the selling. He is probably in the back room at night with his wife and kids making the products. He manages the company successfully up to \$1 million in sales.

"As he then moves toward \$5 million, he realizes that he has so many customers he needs to hire sales people. So now he has to be sure that he is capable of handling a significantly different type of operation than the one he started. He now has a sales manager at a very decent salary and he has hired a controller and manufacturing employees. He has a substantial payroll and fringe benefits and all kinds of headaches he didn't have before. He can't operate out of his back room any more, so he has a plant and some fairly sophisticated equipment. He not only has current liabilities, but contingent ones. At the \$1 million stress point, he has to anticipate that further growth will bring on all those situations and prob-


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lems, and he has to be sure that he is equipped to deal with them and to continue to be an effective manager of what is really a very different business.

"The same challenge arises at the $5-million stress point. He is now in a position where he has to have a national sales manager with a sales force of perhaps 15 people, has to plan and supervise expansion of the production facilities and the work force and has to do a lot more delegating that puts him even farther away from his original role. If he can't or won't handle that type of open-ended responsibility, the business could be heading for trouble."

Similar challenges and questions must be faced at the later stress points, Sullivan adds, with each posing a risk for the future of the business if the founder/owner/manager is unable to recognize the need for new thinking and new approaches to deal successfully with each phase.

Another risk for business owners is the assumption that a busy place is necessarily a successful place.

Andrea Ruff of Orlando, Fla., a bankruptcy attorney and president of the National Association of Bankruptcy Trustees, advises against confusing activity with business success. "It's very easy to do, when you're wrapped up in everyday, fast-paced affairs and there are a million things for the boss to do." But, if the boss is not making sure that the activity is actually generating revenue and not just accounts receivable, the business could be headed for serious trouble, she warns.

"You need to operate on a strict, cash-buoyant basis. When people don't pay you on time, you are really making a loan to them, and if you don't have money to loan, you don't do it," she says.

It was Ken Susnjara's recognition of cash flow problems that triggered action at Thermwood when it failed to realize its expectations for sales of the painting robots. In fact, he recalls, "We were out of cash and we were continuing to lose money."

It was the most serious problem he had encountered in a business career that began with a mail-order operation he started while earning a mechanical engineering degree at the Rose-Hulman Institute of Technology in Terre Haute, Ind. He sold wheel covers used for smaller aircraft with nonretractable landing gear.

Susnjara worked for ALCOA for 18 months after graduation, then founded Thermwood in 1969 in a barn—"a real, chase-the-cows-out kind of barn." The company made plastic, decorative parts for the furniture industry. It was doing well until the energy crisis of the early 1970s drove up the price of petroleum, the raw material for plastic. "I saw the market starting to slip away," Susnjara says.

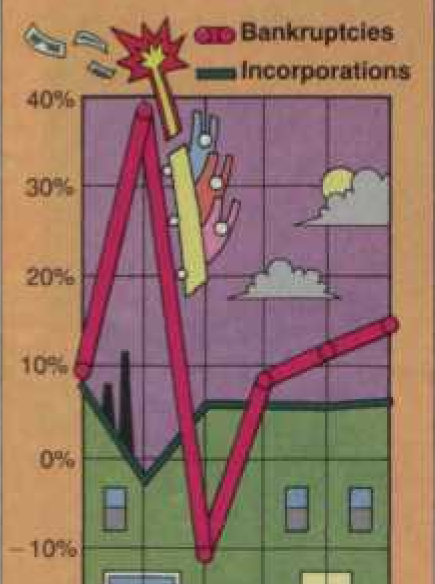
But a means of diversification was at hand. In building the plastic parts business, Thermwood had developed its own production equipment, and Susnjara decided to begin making and selling that equipment to other companies. One of the first and most successful products was a computer-controlled router. The shift to making equipment for other manufacturers led the company into robotics and the resulting problems that brought it to a crisis point.

One of those problems was its gross overestimate of the market potential.

"Robots became a very glamorous industry in the early 80s," Susnjara says. "There was a lot of press about the coming revolution in robotics, which was going to be the next big development of the computer era. A whole bunch of people were going to make a lot of money. People who got themselves positioned properly would be carried along on the big wave that was about to hit."

Starts And Stops

U.S. Incorporations And Bankruptcies: Percentage Changes From Previous Years



*Year Ending June 30, 1986

Source: U.S. Small Business Administration

Another problem was a series of expensive commitments to prepare to capitalize on that assumed market: "We spent big money on research and development. We live out in the country, and we hired what we considered 'big city' marketing experts. We got some outside board members to come in and help guide us poor country boys who weren't real sure of what we were doing."

Susnjara describes the bottom line of all that activity: "What we were actually doing was spending an enormous amount of money for a market that really never developed. We had a huge marketing organization and a business plan you could run IBM with. The problem was that nobody was paying any attention to the mundane, day-to-day tasks like selling products."

Eventually, he says, "We were out of cash and continuing to lose money." He launched his turnaround campaign, which included stringent cost-cutting. "Stretch costs below current levels and you're making money," says Susnjara. "Forget the consequences. Just cut them."

The goal, he said, was a year of profitability based on the cost-cutting. With that record and past performance, Thermwood was in a position to obtain outside funding to take care of critical problems with vendors and meet other overdue obligations. One effect of the turnaround campaign was a reduction in the work force from 135 to 85.

The recovery campaign also included reorganization. The robotic painting and production-equipment units were established as separate divisions, each with its own product development, sales and marketing facilities. A third division was established to handle customer services, training and related activities. The newly appointed vice presidents of each division were told they were, in effect, in charge of independent organizations with their own budgets and performance standards.

"The thing turned around almost instantly," Susnjara says. "The decision making became unbelievably pragmatic because people were now spending their own money. They spent it more wisely. Each dollar that went into re-

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Thomas Jackson is back in the stock brokerage business after the failure of his multi-million-dollar real estate development company, but he has also launched a new business of his own, this horse farm near Princeton, N.J.

search and development produced 10 times the result that it did when we had a separate R&D group. Each of the two production divisions is now turning out highly improved products, including a new model of the painting robot."

The company is again profitable overall, Susnjara reports. The robot division, with realistic sales goals, should be in the black sometime this year, he says.

While the idea of explosive growth for sales of the robotic paint sprayers has been abandoned, he still sees it as an important market for his company, particularly in view of demographic changes that mean a shrinking labor pool. "When there are fewer workers available, they are able to get better jobs," he says, "and you can't hire them for simple jobs like spray painting."

While Thermwood ran into cash-flow problems for fairly classical reasons, it is also possible that a problem can develop when capital is too readily available, as Thomas Jackson discovered when he left the stock brokerage business to start a real estate development and hotel business in the Carolinas.

PHOTO: DARIO PERLA

A chance invitation to vacation at Wrightsville Beach, N.C., presented him with an opportunity to buy two houses with 10 percent down and a pledge from the sales agent to rent them at a price that would cover the down payment in one season.

Jackson's next step was the purchase of a $450,000 hotel at Myrtle Beach, S.C., with a $75,000 down payment that was also recovered the first year. A second hotel was acquired under the same conditions. "I decided, hell, this is great," Jackson says, "and I decided to quit Wall Street."

After many hotel guests indicated interest in purchasing homes in the area, Jackson acquired a 618-acre plantation to develop and sell as home sites.

"It went like wildfire," he recalls. "Wall Street was selling real estate investment trusts, and we had mortgage brokers banging on our door daily to tell us they had another $100 million to push out this month."

Warning Signs Of Bankruptcy

Back when the West was wild, pioneers looked to the horizon for Indian smoke signals. Spotted in time, the signals could save alert wagon trainers from disaster.

In the wild world of business, smart entrepreneurs should also look for smoke signals, says Reuben Abrams, a CPA at the New York office of the accounting firm Laventhol & Horwath. Most bankruptcy warning signs occur so gradually that they often go undetected by the principals of small businesses.

Abrams, who has 25 years' experience in working with bankruptcy cases, says the following signs are warnings of a firm threatened by bankruptcy:

- Financial management is lax. No one knows how the company's money is spent.
- Company officers, too busy to keep tabs on the bookkeeping, have trouble providing information or documentation of corporate transactions to the accountant.
- Officers and family make repeated emergency loans to the company. Abrams says this usually means the business cannot get credit from banks.
- Customers are given large discounts if they pay more promptly. Products are put on sale to generate cash. This puts a faltering company in greater jeopardy by reducing needed markup.
- Contracts are accepted below standard price to generate cash. This is only a temporary—and eventually suicidal—answer to cash flow problems.
- The bank wants loans subordinated. If a business owner lends money to his company, the bank wants a guarantee that the company will not pay back the owner before the bank. In other words, the bank suspects the business is in danger.
- Sales decrease without an accompanying cutback in the amount of inventory ordered. A business owner who lets this inequity mount will inevitably suffer big cash flow problems.
- Key personnel depart suddenly.
- Inadequate supply of materials delays or halts the company's product shipments. This may indicate that suppliers have not received payment for some time and are not extending further credit.
- Payroll taxes are not paid. Thinking that the IRS's lag time in catching such delinquencies will give your business time to recover spells disaster.

When business owners see any of these warning signs, says Abrams, they should immediately seek the advice of a CPA or bankruptcy attorney.

"Get rid of unprofitable divisions and products," says Abrams. "Cut back from three locations to two. Do everything you can to improve cash flow."

But unanticipated events brought the whole thing down. The oil crises of the 1970s sent business at the hotels plummeting, and a money crunch caused the bankruptcy of the business's principal lender. Construction liens were placed on properties under construction, and, unable to sell them, Jackson found himself in both business and personal bankruptcy.

Jackson, now 49, could not return to the brokerage business immediately because of the pending bankruptcy proceedings and, at one point, was selling carpets in Saudi Arabia while waiting for the court action to end. When considering whether to hire a person who has gone bankrupt, he explains, brokerage firms wait to be sure that the legal process does not turn up any signs of fraud, which was not a factor in Jackson's case. But, while the legal process is under way, "it is pretty tough to find much of a responsible job anywhere," he says.

Looking back on his experiences in the highly leveraged development and hotel venture, Jackson comments: "We were dumb enough not to let enough equity build up. We thought the great things would go on forever."

With his company in debt and his sales activities near a halt, Jackson went under.

He eventually made it back to Wall Street, where he holds a full-time job while running a new business enterprise on a far smaller scale than his initial venture. He owns a 23-acre horse farm near Princeton, N.J. His wife, Angella, runs the operation during the week, and Jackson reports it is making a profit. He anticipates that the value of the property will appreciate over time, but he has no specific plans for selling it.

While some companies reach the point where they feel that a bankruptcy filing is the only alternative, business people in financial difficulty should realize that a Chapter XI proceeding is not a refuge but "carries with it some significant problems of its own," says Burton G. Buser, president of Preferred Business Services, a Tustin, Calif., consulting firm on business turnarounds. For one thing, he explains, the owners of the business turn over control of it to others and assume an added financial burden of court costs, attorneys' fees and the expense of compiling the voluminous paper work involved.

Another problem, he says, is the slowness of the Chapter XI proceeding, which is designed to reorganize the company so it can keep operating, and the high percentage of Chapter XI cases that turn into Chapter VII proceedings, which end in the liquidation of the business.

Buser suggests these six steps to avoid business failure:

- *Establish a plan of action.* Use a worst-case scenario for expected cash flow as the basis of a financial blueprint. This plan becomes the bottom line on which the company can survive. The most important point is that cash is the ultimate resource and cash conservation is essential in a turn-around situation.

> *I began to see the company that I had founded in a totally different light. When I was the chief executive, the things the company did appeared to be the right things to do. When I became a distributor, many of those same things looked ill-considered, and some of them looked foolish."*
>
> —Kenneth J. Susnjara of Thermwood Corporation

- *Sell your plan to your secured creditors.* Their financial support is essential to the final implementation of the business plan. To foster this support, provide assurances that dollars due secured creditors will not be paid to general, unsecured creditors.
- *Talk to unsecured creditors.* Each of the unsecured general creditors must be contacted on any proposal to halt payment of paydowns. Keeping lines of communication open allows for continued trade and, more importantly, dialogue with the creditors. This gives your company an opportunity to improve its credibility. Prepare a presentation that includes the high points of the business plan, in addition to a paragraph or two describing the need for a moratorium with a one-for-one rollover. In such a rollover, payments on receipt of goods or services are applied to the oldest invoices on an open account. In dealing with creditors, it is essential to prepare a listing of those from whom support is expected and those anticipated to be troublesome. Then, systematically contact creditors on a declining scale by dollar amount owed and area of need for support.
- *Try to avoid creditors' meetings.* These tend to result in turmoil and decrease your company's control of its financial situation. Keeping creditors properly informed with accurate and timely information is generally a better alternative.
- *Be sure checks are covered.* Avoid bounced checks at all costs. Bouncing checks will result in distrust of the trade and force you into time-consuming use of cashiers' checks to pay for goods.
- *Keep in contact.* Let creditors know how the company is doing and stress the importance of their continued support in the efforts to put the company back on its feet.

Buser sums up: "By developing and working a strong business plan, opening the lines of communication and restoring credibility with creditors, it is possible for a company to emerge from serious financial difficulties without the stigma attached to bankruptcy and find itself again on the road to profitability."

It is obvious from the experts' advice and from the experiences of those who have staved off business failure and those who haven't that the actions necessary for staying afloat can be difficult and trying.

But, on the basis of many years of dealing with companies in difficulty, consultant Emery Toncré offers this ultimate advice:

"Bankruptcy should *never* be considered an acceptable alternative to your business problems. No one can be counted a loser until he or she stops trying and withdraws from the game of survival. A prospective business owner should never enter into business with the notion that one can always file for bankruptcy in the event that something goes wrong.

"Declaring bankruptcy is a last resort to be used only when all other avenues for resolving the problem are closed. Being able to *avoid* bankruptcy is the key that locks forever the door to business failure." NB

To order reprints of this article, see page 69.

International Spotlight

By Henry Eason

Going South To Cut Costs

U.S. firms are turning to Mexico because of high labor costs at home. Officials say that by improving the companies' health, workers like these at an RCA plant in Ciudad Juarez (left) or at a Ran-Kord Associates electronics plant in Mexicali (right) are not taking American jobs.

PHOTO: PAUL CONKLIN

If American labor costs are pricing you out of the market, you might follow the example of an increasing number of U.S. firms that have gone offshore without having to cross anything wider than a river. Mexico is becoming a better alternative for assembly and light manufacturing operations than Hong Kong, Taiwan or South Korea.

Labor-sourcing just south of the border has the added advantage of boosting the economies of border towns from San Diego on the Pacific to Brownsville, Tex., on the Gulf of Mexico.

Take San Diego. It forms a 3 million-person metropolitan area with Tijuana, offering a blend of white-collar and blue-collar workers. A company can have its assembly plant in Tijuana and its primary manufacturing, as well as its administrative, engineering and warehousing activities, in San Diego.

Along the border such operations are called "maquiladoras," after a U.S.-Mexican program allowing low duties on goods assembled in Mexico.

Paul Deverman, vice president of the San Diego Economic Development Corporation, says maquiladoras "have really helped economic growth in San Diego. We are not trading American for Mexican jobs."

Last year, a dispute erupted in Congress after some members, influenced by organized labor, won passage of legislation that forced the Commerce Department to lessen its support for a maquiladoras educational campaign. The United Auto Workers, the AFL-CIO, the International Union of Electronics Workers and other labor groups bitterly complain that Mexico is siphoning off U.S. jobs.

Alexander Good, head of the Commerce Department's International Trade Administration, says maquiladoras "help U.S. companies to remain healthy in the face of intense international competition and keep U.S. employment levels as high as possible."

The Mexican investment climate until recently has often been characterized as almost hostile to outsiders. But the American business community was heartened last year by President Miguel de la Madrid's open-arms appeal for business partnerships between Mexicans and citizens of their northern neighbor.

"The necessary formalities for obtaining approval of investments have been reduced," de la Madrid told an audience at the U.S. Chamber of Commerce. "The country's available infrastructure, well-trained labor force and proximity to the industrialized world's largest market, together with a legal framework designed to encourage and provide confidence to the foreign investor, are all at the disposal of the international community."

Says Mario Rodriguez, commercial attaché at Mexico's embassy in Washington: "We are working from a market-oriented philosophy now." He says the government will show flexibility in permitting American firms to have majority stock ownership in their Mexican subsidiaries—a concession many Third World nations will not make.

A lot of stereotypes are fading in Mexico. Last year the country joined the General Agreement on Tariffs and Trade and introduced a host of private sector-oriented economic reforms, including reduced tariffs and price controls, lower domestic industry subsidies and transfer of some state-owned firms to private hands. Says Rodriguez: "We are trying to send a signal to the United States and the rest of the world that Mexico is opening up a free market economy."

A Warmer Embrace Of Canada?

When we think of import-export issues, we usually think in terms of Japan, West Germany or South Korea. But this year's sleeping giant issue in international trade involves Canada. Don't yawn. More than $145 billion worth of goods and services annually flow across our common border, constituting the world's biggest bilateral trade relationship. And last year, Canadians sold us $20 billion more than they bought from us.

A lot of money is riding on a proposal to drop all trade barriers between Canada and the United States.

The outcome of negotiations now under way, some experts say, will cast light or shadow on the ongoing 92-nation talks in Geneva designed to produce a freer world trading system. "If the top two trading partners can't agree, it would not bode well for the global talks," says C. Fred Bergsten,

International Spotlight

Canada and the United States have the world's biggest bilateral trading relationship, but there have been recent feuds over what Americans say are improperly subsidized Canadian wood products. A proposal to drop all trade barriers between the two countries is under discussion, and the result will influence multinational trade talks.

director of the Institute for International Economics in Washington.

Down on an individual level, U.S.-Canadian free trade has a very concrete meaning to Michael Mortimer and the Canadians with whom he does business across the border.

"We have difficulty servicing our products," says Mortimer, the president of M.H.P. Machines, Inc.

"Our people can't work in Canada," he continues, "and the Canadians can't get their people in here, unless they are specially invited."

That, according to Mortimer, usually turns out to be a winding walk down a bureaucratic paper trail.

Last year Mortimer's firm sold $1 million in high tech engineering equipment to Canadians, mostly in Toronto, a vibrant market only a two-hour drive from Buffalo.

Mortimer's employees number among the 4 million on both sides of the border whose jobs are tied to bilateral trade.

The free trade argument is that even more jobs could be created with untariffed borders and that goods and services would be priced more in accordance with the peculiar strengths of the two economies.

Teams of Canadian and American officials are elbow deep in negotiations over intellectual property protections, government subsidies that give certain industries unfair export advantages, investment issues, product standards, customs regulations, government buying practices and services trade regulations, as well as talks on tariffs on merchandise.

Lately, the neighbors have been feuding over what Americans say are improperly subsidized Canadian wood products. The Canadians retaliated against higher U.S. duties on some lumber imports with their own steep duties on American corn imports. There is historic friction over steel, machinery, investments, cultural products and numerous other goods in economies that compete with each other in many sectors.

In Ottawa, Prime Minister Brian Mulroney's market-oriented administration is waging the sort of battle with protected Canadian industries that President Reagan's administration is fighting with American protectionists in Washington.

Free trade will produce both winners and losers—but many more of the former than the latter, argue Reagan and Mulroney.

PHOTO: OTTMAR BIERWAGON—BLACK STAR

"Our imperative," says U.S. Trade Representative Clayton Yeutter, "is to construct a win-win agreement—one that will enrich both sides. Such an agreement must create jobs on both sides of the border. It must create productivity on both sides of the border. It must create a North American market with such economies of scale that firms on both sides will be able to strengthen themselves to take on the world with enhanced international competitiveness."

Pat Carney, Canada's minister of international trade, says: "If the negotiations fail, this historic opportunity will have been missed. We will have missed an opportunity to create jobs. We will have missed an opportunity to promote new growth. We will have missed an opportunity to show the world the way to trade liberalization."

Tadashi Kuranari, Japan's Foreign Minister, says his country is making strong efforts to increase domestic demand and promote imports.

PHOTO: WIDE WORLD PHOTOS

An Opening In Japan

Japan's one-sided approach to international trade, which has produced an export juggernaut that has created great wealth for Japan and trade deficits for other nations, is being systematically dismantled, according to Foreign Minister Tadashi Kuranari. He told *Nation's Business*: "There is a strong awareness within Japan that expanding Japanese domestic demand has an important role to play in leading the world economy to a more balanced expansion, and that there is a need to actually expand imports."

The Foreign Minister explained: "It is certainly not easy for Japan or any other country to change deeply embedded economic patterns, but we are determined to tackle the task."

Kuranari says the Japanese public realizes it is in Japan's interests to increase domestic demand and promote imports.

Trade experts say that with the appreciating yen giving American business an edge, U.S. exporters are well advised to make a push in a Japanese market that was virtually closed to them during the low yen days.

MANAGING YOUR BUSINESS

The Uses Of Meetings

Meetings should spark ideas and solve problems, not simply cover the manager who calls them.

By Norman B. Sigband

"I hold more meetings than ever before. It's because I really believe in participative management."

These pious words certainly seem to reflect the new manager—who respects and listens to his or her people and wants to give them a piece of the action.

But all too often, what the words reflect is insincerity.

More and more these days, managers are calling meetings not to find ideas and solve problems, but simply to cover themselves. A manager who should be making decisions on his own is not. Instead he calls 10 or 12 colleagues and subordinates together, secures a consensus and announces the decision. If the decision turns out to be poor, he can always say: "Don't blame me. That is what the participants to our August 23 meeting wanted. It was their idea, not mine."

On the other hand, if the decision was good, the same manager will not hesitate to point out "how carefully I led the August 23 meeting."

I learned not long ago of a meeting at a small plastics manufacturing firm. Present were a division manager, six department heads and the heads of three sections. The topic: Should a replacement be hired for a recently injured secretary, or should a typist be secured from a temporaries service and kept on a week-to-week basis?

It took 50 minutes to reach a consensus on that question. Actually, the decision should have been made privately by the division manager or by the manager of the one office involved.

What was decided is not important. The effect of such meetings on the company is. Because of the length of the discussion about the secretarial replacement, time ran out before a second topic could be considered. A decision on it was not reached until another meeting weeks later. The topic: Should a new fluorescent lighting system for the plant be installed? Involved were not just one office but four departments—not to mention a $28,000 investment.

Norman B. Sigband is a professor of management communication at the University of Southern California's School of Business, an author and a consultant to dozens of corporations.

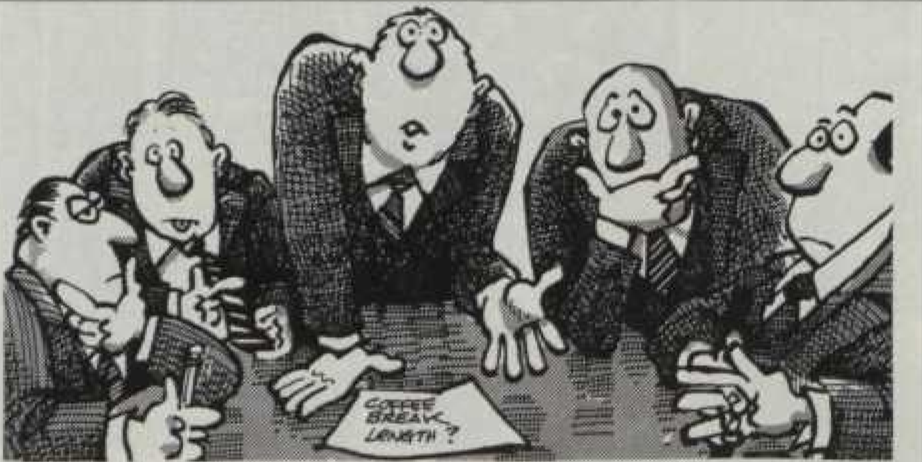

ILLUSTRATION: WILLIAM COULTER

It should not be that way. First of all, meetings are expensive. When 12 people, each paid $15 to $25 per hour, meet for two or three hours, the cost for one session may easily exceed $500. Such a price is justified when it is necessary to bring representatives from engineering, production, finance and marketing together to solve a legitimate problem. But when the session is held to get a consensus on whether coffee breaks should be taken at 10 a.m. and not at 10:30, or whether the copying machine should be moved 50 feet, blowing $500 worth of time on a meeting is unconscionable.

Second, when a manager calls meetings to decide on items that are inconsequential or that he should handle himself for other reasons, the importance of future meetings is diluted. People will find reasons not to attend whenever they can—a pity, because there will be some vital meetings that require input from everyone invited.

And third, when meetings are called by a manager who wishes to spread responsibility, a signal is given to his subordinates: "This is a policy you may wish to follow when you become a manager. Always cover yourself."

These situations tend to reduce initiative and harden the organizational arteries.

How can they be eliminated? For starters, by changing the company climate. This is almost totally dependent on the chief executive officer and his staff. They must make it clear that a decision that does not work out does not automatically mean decision makers will have their heads chewed off—that it is acceptable to fail, provided the decision was based on careful analysis.

Another important step is policy setting. Companies have written policies on all sorts of subjects: finance, production, construction, personnel, marketing, employee benefits, quality control and on and on.

Why not policies on meetings?

Such policies should be aimed not only at cutting down on unnecessary gatherings called by managers who are reluctant to make decisions, but also at ensuring that every meeting is as productive as possible. Specific requirements:

1. Hold only meetings for which there is a verifiable need.

2. Decide on an overall purpose and series of objectives each time.

3. Invite only people who can make a definite contribution.

4. Distribute an agenda and necessary handout materials to each invitee prior to the session.

5. Make all mechanical arrangements ahead of time (room, projectors, seating, transparencies, etc.).

6. Begin and end every meeting on schedule.

If you consider the losses in both morale and dollars when people are made to sit through unnecessary meetings, such as those to make decisions a manager should have made on his or her own, it is obvious that a list like this should be distributed to all managers and that they should be made to stick to it. ■

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Akio Morita, Sony	Feb. 23-27

Co-anchors Meryl Comer and Carl Grant

MANAGING YOUR BUSINESS

Raising Venture Capital Now

Tax reform could make this vital task tougher for entrepreneurs.

By Joan C. Szabo

When Robert Molloy, president of CyberResearch, Inc., a 3½-year-old New Haven, Conn., manufacturer of high tech products, goes searching for venture capital, he finds the task challenging. "Before tax reform, when the top capital gains rate was 20 percent, the job was hard. Now that the tax advantage is gone, it's all the more difficult to find an investor willing to take a risk in a new venture."

He adds: "Only a small number of companies can ever hope to obtain seed capital from an institutional venture capital firm. Most small businesses must look to friends, relatives and informal investors, often referred to as angels, for their start-up funds."

Even so, CyberResearch will do just fine.

"With necessity being the mother of invention, we've come up with other ways to raise money, such as convincing customers to prepay their orders," Molloy says.

"Our sales terms," he explains, "are 40 percent in advance with the order, 40 percent on delivery, and 20 percent within 30 days." In addition, Molloy says he has encountered a few angels that have played a significant part in helping the company meet its cash flow needs.

CyberResearch has launched a desktop publishing system called CyberType that it expects will help raise company sales to more than $4 million this year—substantially above the 1986 level.

Opinion is mixed over whether Molloy's experience in managing to raise capital is typical of what other entrepreneurs' will be as they try to do the same thing in a new tax era.

On one hand, a number of experts say tax reform will make finding venture capital more difficult. Some will even try to work for restoration of the capital gains tax differential in the tax code. But others think the new law could actually help spur the flow of capital to small companies.

Simply put, venture capital is the pool of risk funds available to start or expand a small company. Institutional and private investors offer money and management aid in exchange for an ownership position in a new firm through securities including common and preferred stock and convertible debt instruments. Unleveraged venture capital firms use proceeds from stock sales to buy equity in small firms. Leveraged companies borrow most of the money they funnel into new companies.

Tax changes not only will affect entrepreneurs' ability to attract funds, but also to attract good managers. Princeton, N.J., venture capitalist Bradford Mills says compensation packages will have to be redesigned. The balloons? He was celebrating his birthday when we visited him.

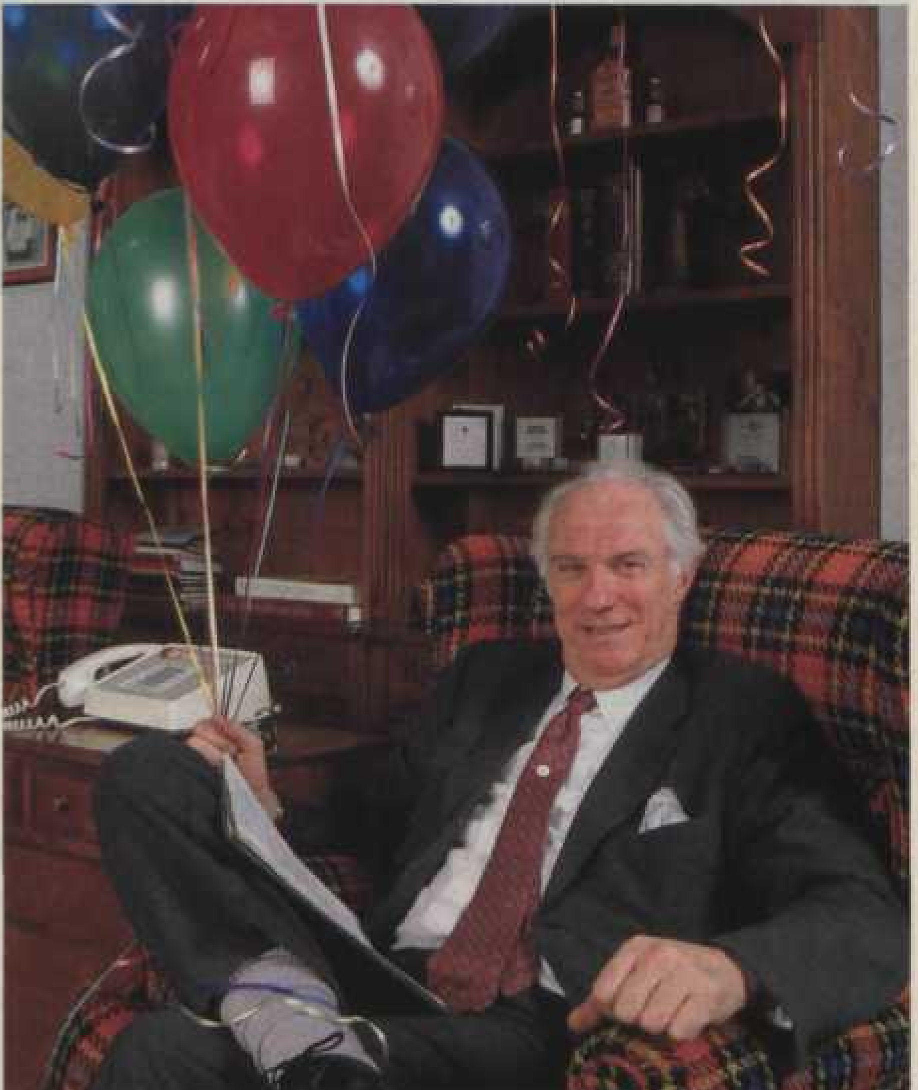

PHOTO: TOM SOBOLIK—BLACK STAR

Investors typically hope that the small firm they back—though it often pays them nothing immediately—will take off so well that their initial investment will grow a whopping three to five times in 10 years or less.

Many of these start-up companies are in high growth, glamour industries such as electronics and computer hardware, but other lines also get venture capital infusions.

After a period of years, assuming the new or expanded firm is successful, the investor sells out—either to the company, to the public or to a larger firm that

Raising Venture Capital Now

Burton McMurtry, a general partner in Technology Venture Investors, Menlo Park, Calif., says the people who used to put their money into tax shelters won't like the risks involved in venture capital deals. He also says an entrepreneur may now have to give investors quicker returns. Where might the money come from? McMurtry's answer is below.

PHOTO KAREN BORCHERS

acquires the company. Which is where the new tax law comes in.

Ending the special treatment of long-term capital gains means profits made will be taxed as ordinary income. Starting in 1988, the top capital gains rate—20 percent from 1981 through last year—will be as high as 33 percent if the taxpayer is in the 5 percent surcharge range.

By lowering ordinary income tax rates and raising the tax on capital gains, tax reform "creates a bias in favor of more secure investments," says Daniel T. Kingsley, executive director of the National Venture Capital Association, which represents 213 professional venture capital companies.

Investors can now keep more of the interest and dividends on safer investments such as government bonds and blue chip stock. Since they get to keep less of capital gains, Kingsley argues, there is less incentive to tie up funds for several years in risky start-up ventures.

Some experts say the past shows a causal relationship between high capital gains rates and smaller amounts of venture capital.

Figures from Venture Economics, Inc., of Wellesley Hills, Mass., a research-information firm specializing in the venture capital industry, show that in 1977, when the top capital gains rate was 49 percent, the size of the venture capital pool was well under $3 billion. In 1981, with the rate at 20 percent, the pool totaled almost $6 billion.

When fewer dollars flow to venture capital deals, experts argue, fewer firms are launched, fewer jobs created and fewer innovative products reach the marketplace. Not only is this harmful to U.S. economic growth and our international competiveness, "it makes raising venture capital harder for entrepreneurs," says Ginger M. More, a general partner of Oak Investment Partners, a venture capital firm based in Westport, Conn.

An entrepreneur will "have to raise more money than he needs."

"Tax reform won't harm the raw supply of entrepreneurs, but it will harm the supply of funds," predicts National Venture Capital Association President Burton J. McMurtry, who is a general partner in Technology Venture Investors in Menlo Park, Calif.

Despite the concern, no one expects tax reform to deal a death blow to the venture capital industry. The new law is "a dampener, not a killer," says Patricia Cloherty, general manager of Tessler & Cloherty, a New York venture capital firm.

Experts who say tax reform will not adversely impact the venture capital flow downplay the capital gains differential. Arnold G. Rudoff of San Francisco, national director of partnership analysis for the big accounting firm, Price Waterhouse, says that "in most arrangements, the tax aspect is not the driving force. I'm finding that people are still willing to do good deals and that money is still being raised. They haven't cut off the spigot." Investors will accept greater risk if they think they can earn at least 20 percent annually on a venture capital investment, experts argue.

Says Walter M. Wellman, chairman of Wellman-Thomas, an Atlanta venture capital firm: "The after-tax rate of return for venture capital investors is likely to go down under tax reform, but the returns will still be attractive."

In addition, pension funds and some other large institutional investors that provide much venture capital are exempt from taxation and will not be affected by the elimination of the special capital gains rate.

Some think that pension funds will become a greater source of venture capital in the future. The shift already may have started. Venture Economics, the research firm, reports a dramatic shift in venture fund sources. Pension funds typically have provided 30 to 33 percent of the capital each year; their share jumped to 47 percent in the first six months of 1986. That may be partly attributable to the dollar's falling exchange rate, which helped to diminish that portion of capital provided by foreign investors.

Some experts argue that investors, now effectively shut out of nonproductive tax shelters, will funnel their money into promising growth companies.

McMurtry disagrees. He says that "these individuals were investing in a sure thing—they knew they would receive X amount in tax savings," and he adds that sure-thing seekers will avoid the risks of venture capital investments.

David A.R. Dullum, a general partner in Frontenac Venture Company in Chicago, does not see new hurdles for the entrepreneur in getting capital because of tax reform. But he does expect a restructuring of deals. For example, offering a current return on their money could actually help attract investors to the field, he says.

Because current income now becomes as important as capital gains, some experts believe investors will have to be offered a quicker return, perhaps in the form of interest-paying debentures that the investor can convert to stock at a later date. Many individual investors will be less willing to wait the normal several years to receive a return, the experts argue.

An entrepreneur who does not expect to have enough cash flow to pay an immediate return to investors will "have to raise more money than he needs to run the business, which means he owns less of the company," McMurtry says.

Russell French, a lawyer and general partner in Noro-Moseley, an Atlanta venture capital firm, agrees with McMurtry's conclusion: "Income is now as important as capital gains to the investor. So it will cost more from an entrepreneur's point of view. The money an entrepreneur pays out as a dividend is coming out of his business."

Robert Molloy, president of CyberResearch, a small, New Haven, Conn., manufacturer of high tech products, has managed to raise capital with new techniques, including persuading satisfied customers to prepay on what they are buying.

PHOTO: T. MICHAEL KEZA

Another big drawback to the end of special capital gains treatment, experts say, is that it will be more difficult to attract the best managers—a key ingredient in the growth of a new company. The reason: Equity-based compensation becomes less enticing. Why would a good manager at a large company give up his salary and benefits for possible profits from the sale of a new company's stock—profits that will be taxed at the same rate as ordinary income? "That is where tax reform will hurt venture capital deals most," says Robert Premus, professor of economics at Wright State University in Dayton. He says younger companies do not have the cash to compete with bigger companies for the best talent. Says Richard Testa, a Boston attorney and venture capital specialist: "It is becoming harder and harder to get individuals to go to work on a nuts and berries diet. The new tax law is going to make it more difficult still."

Rudoff agrees that it will be harder to attract the best people, but, he says, "Prospective managers don't decide to join a new company just because of stock options. In most cases these individuals have an entrepreneurial spirit and become involved for the challenge."

Because equity compensation loses some of its drawing power, many experts say struggling entrepreneurs will have to offer higher salaries to attract the best individuals. "Starting wages for top-notch managers have already increased 15 to 25 percent because of tax changes," says Theodore H. Elliott, Jr., chairman of Prime Capital Management Company, a Stamford, Conn., venture capital firm. Offering managers higher salaries means the cash-constrained entrepreneur won't be able to hire as many as he would like to, McMurtry says.

Another approach is to "tie performance to profits," says Bradford Mills,

Caution Returns To Funding

After a 1982-1983 period of frenzy, when too much money chased too few solid deals, and many shaky high tech enterprises financed by venture capitalists crashed, the venture capital industry is back to normal, according to Ginger M. More.

More, a general partner of Oak Investment Partners, a Westport, Conn., venture capital company, says: "Gone are the times when just anyone could get funded."

For entrepreneurs, this means undergoing closer scrutiny by the venture capitalists.

Statistics on the raising of venture capital reflect investors' caution, experts say. Venture Economics, Inc., of Wellesley Hills, Mass., reports that slightly less than $1 billion in capital was raised by private venture funds in the first six months of 1986. In the same 1985 period, $1.25 billion was raised. Venture Economics says capital raised has declined in each six-month period since the second half of 1983, when the figure was $2.2 billion.

Is the venture capital supply outlook grim? No, says More. "While the industry may not be quite as frantic as it was in 1982, it is alive and well and still very exciting."

managing partner of Bradford Associates, a Princeton, N.J., venture capital company. "If the individual is highly qualified, reward him," he advises. For example, you offer a manager 5 percent of pretax profits. If the company succeeds, the manager could make a million dollars. Mills expects compensation packages will be redesigned with a heavy emphasis on profits, rather than on stock.

Kingsley sees an anticompetitive aspect to tax reform. That is because companies that have been in business for a few years will not be hurt as much as those just being launched, he says.

Investors still willing to put money at risk are more likely to invest in a company with a track record than in one just leaving the starting gate, he says, adding: "National Venture Capital Association members are already putting less money into the riskier start-ups." New York venture capitalist Cloherty says her company has begun to direct more capital into later-stage firms.

Boston attorney Testa says: "It is likely that there will be fewer start-ups, but those that do get off the ground will be of a higher quality."

Testa also expects that entrepreneurs will have to produce results more quickly. "If a company doesn't perform in the first two years," he says, "you won't give it another two or three to prove that it can."

But the jury is still out on just how much tax reform will change the venture capital picture. Says Professor Premus: "I don't know anyone who is sure how it will all turn out."

Atlanta's Russell French, though, is willing to make a prediction that is more or less optimistic: "The good investment opportunities will get funded on basically the same economic terms as before. Companies with an upside potential will be able to attract management in the same way as before. Compensation structures will be different, but stock options still remain viable. Tax reform is not going to change the basics."

Even so, Kingsley's National Venture Capital Association does not plan to take a wait and see attitude. It will encourage Congress to restore a meaningful capital gains differential, says Kingsley—"We are committed to that." NB

To order reprints of this article, see page 69.

Franchising: Find That Niche

The newest franchisors are succeeding by using the traditional entrepreneurial route. They are first in the market with a new idea.

By Ripley Hotch and Meg Whittemore

When franchising started to grow exponentially in the 1960s, observers were fond of saying—sometimes apprehensively—that anything could be franchised.

They didn't know how prophetic they would turn out to be. With as many as 500 new franchises being created each year (because of the speed of franchising's growth, nobody knows the precise numbers), variations on established franchise concepts and unusual new ones still spring up like mushrooms after a spring rain.

Says Irl Marshall, immediate past chairman of the International Franchise Association: "The genius of franchising is the capacity to respond to the demands of the marketplace. The keen entrepreneur seeks a niche in the market—an unfilled need, an opportunity." Then, Marshall adds, the franchise method, which uses the franchisee's capital to supplement the franchisor's, allows rapid expansion to meet demand.

Some concepts strain the outer edges of ingenuity and disappear before even a pilot program is set up. Preserve-A-Pet was one of these (yes, deceased pets were to be freeze-dried). Somewhat more mainstream, and still in existence: Pets Are Inn, a Minneapolis franchise that arranges pet sitting by senior citizens for animals whose owners are going out of town.

New franchisors are trying to attract franchisees with entirely new concepts as well as variations on some that have worked well in the past. Although food franchises continue to be the most popular of concepts, they are also the most risky. At one time, franchisors were promising to be "the new McDonald's." Now they often claim to be "the new Domino's Pizza." But both of those franchises had long struggles to make it to the top.

Every franchise concept that succeeds seems to follow the McDonald's-Domino's pattern: being first in the field with the method and product; expanding quickly when the opportunity arises; clinging ferociously to trademarks and business methods; and continuing to innovate. The start-up generally depends on a single, simple idea or product and then adds complexity as the franchise ages.

Meg Whittemore is a Washington freelance writer.

Greg Wyers' Camera America, a Valdosta, Ga., combination of photo finishing and camera equipment retailing, exemplifies franchising's move into new niches.

Atlanta franchising consultant Les Rager says being solidly first with a concept is the top requirement, because there are going to be many imitators. "A lot of people who are fantastic athletes in high school never make it in the pros," he says. "For every all-star Marcus Allen, there are 100,000 just as good who never played football. It's the same with franchise companies. You have to have money and be in the right place at the right time."

The best opportunities, Rager says, are in the service field, which he calls "the epitome of franchising, because you can buy information that will help you do business better than you do it on your own."

New franchisors in a sampling of the many hundreds that have begun operation in the last few years say constantly that they are succeeding because they simply were ahead of the pack in finding the formula that worked.

"We are the first company of this type to franchise," says Dante Pastore of his National Meat & Seafood Company, which delivers high quality meats and seafood, often prepared, door-to-door, mostly to double-income families that have limited time for shopping. Pastore, now 27, founded National Meat & Seafood in 1981 in Newport News, Va., after working his way to the top sales job in a similar firm.

After following the Newport News operation with other company-owned operations in Nashville and in Charlotte and Raleigh, N.C., Pastore decided franchising would work. He sold his first franchise—in Atlanta—last June and now has one in Baltimore, too.

Like many service businesses that have been franchised, home delivery of seafood and meat has been the domain of mom-and-pop operations. "The majority of companies in this business are grossly undercapitalized," Pastore says.

With only $33,000, Pastore was not exactly overcapitalized himself when he started. The difference came in what he charged, and how the proceeds were used. "A lot of these guys sell the product too cheap and don't reinvest," says Pastore. "They blow it. They haven't much business sense, and they fail. We have learned from everybody else's mistakes and have put the money back into the business."

Pastore has also been innovative—for example, in where his franchisees deliver. "You can't just stick to homes; people don't get home till 4:30 or 5:00," he says. "We go to real estate offices and doctors' offices, too." And the company is taking a page from the book of coffee services: "A lot of our customers have put freezers in their offices. We're thinking about putting the machines in ourselves. We want to go to offices and sell 50-60 orders at a crack."

Americans' health concerns, which have grown rapidly in the last decade, have given rise to intriguing new businesses, both in treatment and prevention. One of the preventers is Radon Detection Services, a Ringoes, N.J., franchisor that has taken advantage of recent discoveries about the carcinogenic properties of radon.

"Radon gas has always been around," says RDS President James G.

Franchising: Find That Niche

Some franchisors have had to work hard at making a niche big enough. Chicago's Naked Furniture needed a new owner and a new president—Bill Streb—before it became the unchallenged market leader in the unfinished furniture market.

Davidson. "It comes out of any soil that contains uranium, and virtually all soils do." The increased energy efficiency of many modern houses causes radon to accumulate inside rather than dissipate through air exchange. As a result, Davidson says, "radon gas is the second greatest cause—after smoking—of lung cancer, and it is the greatest cause for nonsmokers."

Lenders' and builders' concerns over liability for selling homes that have high radon levels have prompted many to turn to testing. Davidson entered the field because he was a builder, and a customer two years ago asked him to build a radon-proof house. In the course of research, Davidson learned enough to enable him to start the first detection service. Franchising began last year.

RDS is a classic case of timing; Davidson says it has been fortunate in getting in on the ground floor of a trend to try to avoid elevated radon levels—a trend that is particularly strong in Eastern states. "In New Jersey you don't buy a house without a radon test," he says.

He expects that radon inspections will become as routine nationally as termite inspections. "We have offices in three states already," he says. "We feel that we're going to have a minimum of a dozen this year, and we may have as many as three dozen."

Other new franchise companies are finding unexploited niches in crowded fields, such as business services. New York's American Business Associates has found a way to franchise networking—exchanging business ideas and information—and Priority Management Systems in Vancouver, Canada, has found a new twist on time management training for business people.

"Networking has been around for a long time," says American Business Associates Chairman Jerome Feltenstein. Business people meet informally over lunch, or more formally at Rotary, chamber of commerce or trade association meetings. That kind of networking, says Feltenstein, is haphazard and inefficient, and it can be plagued with competitiveness when those meeting are in the same type of business.

ABA franchisees create business networking "councils" with a maximum of 40 members. No two members represent the same industry, product or service area. "That makes the comfort factor high, and solid leads can be exchanged in an atmosphere of trust," says Feltenstein. Each member pays an $850 fee per year, which allows him or her to attend up to 22 meetings of 1½ hours each. A franchisee pays $25,000 for the right to develop five councils. Although the company has been operating since 1983, it is just beginning to sell franchises.

The advantage of operating with low overhead appeals to franchisees of Priority Management Systems. The company, in operation in Canada since 1982, started moving into the U.S. market in 1984.

PMS President and Chairman Dan Stamp's background was in university teaching, and he applied teaching principles to the business person's management of time. PMS franchisees offer calendar notebooks with seminars and follow-up sessions on how to use company-developed techniques. "We found that people in the marketplace had never been tutored in the most valuable resource: time," says Stamp. "Our most frequent comment from our clients is, 'Why didn't anyone teach me this before?' "

PMS succeeded because, says Stamp, it was the first with its particular teaching concept and because the franchisee market was right. "It was during the [1982] recession, and we had the right kind of potential franchisee available: middle management people who saw the handwriting on the wall and were looking for a reasonable investment in case their jobs disappeared."

Stamp says that when the company began expansion into the United States, it faced a rude shock: "Everything was exponentially more expensive." He agrees with National Meat & Seafood's Pastore that capital is essential, and not just the capital the franchisee brings. Stamp took on a partner with capital and is now on track with 39 franchisees in Canada and 48 in the United States. "There is room for someone to do a McDonald's in the training business," says Stamp.

Another entrant into a crowded field is Camera America, a Valdosta, Ga., company that combines retail camera shops with one-hour photo finishing. Neither concept is new; camera shops and one-hour finishers seem to be everywhere. Even bringing the two operations together under one roof doesn't seem particularly special.

Greg Wyers, founder and president of Camera America, says the secret is packaging, marketing and service.

Wyers, who says the standard camera shop is basically a forbidding place for customers, repackages 35-mm cameras in kits that include camera, case, lenses and instructions. He displays the kits so that they explain themselves. The customer does not need to know a lot of technical information and can feel assured that in buying the package he is getting a complete set of camera gear. In effect, Wyers says, Camera America limits the customer's choice, which makes buying a camera less forbidding.

"We're a camera store," says Wyers, "but when you look in the cases, there are signs that tell customers in plain language what they need to know." All of that means less training for sales personnel is needed, and the franchise becomes more controllable for both franchisee and franchisor. It also means the chain can buy certain items in quantity and offer a price advantage as well. Says Wyers: "That sort of thing has not been possible because this is a field of small retailers. It's a little puzzling to me that photography is the No. 1 hobby in America, but there's no

national merchant—no Radio Shack or Zales. I've always felt that if we could put a national franchise together, the country was ready for it." Camera America has 75 franchises and is looking for 1,000 within three years.

The health field has become crowded with franchisors. But niches are still being uncovered by the innovative. In the works, for example, are franchises that provide treatment for eating disorders or for alcohol and drug abuse.

One newly franchised concept is physical therapy. The American Physical Rehabilitation Network is a subsidiary of American Physical Therapy Company in Toledo, a 30-year-old private therapy practice. The franchise provides physical therapy under contract to hospitals and private physicians.

Physical therapists are "a scarce commodity," says David Coy, APRN 's chief financial officer, and therefore are a hard sell for a franchisor. The company woos them by emphasizing that it gives them a chance to join a large organization that offers joint advertising, business office services, clinic design and marketing.

Coy says that "being first to market" in his field "will give us an edge. And we've got confidence in our ability to execute."

Franchisors in the video field face formidable overcrowding. But niches other than movie rental stores are surfacing.

Video Workshop is a do-it-yourself editing and duplicating franchise based in Fort Lauderdale, Fla. David Bawarsky, Video Workshop's president, did a considerable amount of market research to make sure his niche was viable. He found that 40 percent of U.S. households had VCRs—videocassette recorders—and that the cost of commercial editing was \$50 to \$75 per hour. Says Bawarsky: "In pricing our facilities, I investigated the hourly fees people generally pay for leisure activities, and \$12.50 an hour was not far from the cost of an hour of racquetball or even bowling." That was the price he set.

Bawarsky says the sky is the limit: "We go after the nonbroadcast video business. That is a \$4.3 billion industry that's very low-key. It's even bigger than the commercial video market. I really don't see us peaking out for some time." Video Workshop, too, is first in its field. Says Bawarsky: "We anticipate having some competition, but we don't see any major corporation coming into the market." In any case, he says, planning has put Video Workshop "way ahead."

Another video franchise is Go Video, a Scottsdale, Ariz., firm established by Terren Dunlap and Richard Lang in 1984. Both Dunlap and Lang were aware of the same figures Video Workshop had, and concluded, says Lang, that video "was becoming a communication medium for anyone who owns a VCR" the way paper is used by those with typewriters.

Go Video, however, goes for the busi-

Franchising: Find That Niche

ness market rather than the home market. It sends taping and editing equipment in vans to various sites where franchisees' employees put together tapes on business conventions, ceremonies, sales presentations, tours and training.

Go Video offers the advantage of immediacy, says Lang. Not only is filming done at the site, but "if the client has requested it, we can edit at the site and produce a finished product for the client by the end of the day."

Dunlap says Go Video has been a success because it has been "in the right place at the right time with the right resources," and has "a three-year lead on any competition."

Some companies that are veterans in franchising have had a new lease on life in the last few years. They were in niches a bit too soon, and the market took some time to catch up. Examples are Naked Furniture and United Consumers Club.

Naked Furniture was a leader in the unfinished furniture business and began franchising in 1977. It expanded too rapidly, was forced into bankruptcy and was bought out by General Home Furnishings, of Rochester, N.Y., in 1984. The parent company sent in Bill Streb as president and began a major repositioning that Streb says has left Naked Furniture the market leader and "literally the only franchisor in this area."

Weeding out unprofitable franchises and concentrating on marketing and technology have given Naked Furniture the edge, Streb says. Despite the false start—or possibly because of it—other franchisors "just haven't gotten on the bandwagon yet," he says, though he thinks they will "when the concept has proven itself." He sees the possibility of 600 or more franchises.

United Consumers Club began franchising shortly after it was founded in Anderson, Ind., in 1972, and got to 35 franchises before it halted expansion in 1976.

Anthony Foster, national franchise director for the discount merchandise company, says the problem then was inadequacy in training and other support of franchisees.

"We worked on the program, then tested it for five years to prove that it worked, then molded it, refined it, made it better," says Foster. "We have sold about 35 franchises since 1981 and have had only two failures."

United Consumers charges a flat membership fee of $889 for two years, then a renewal fee of $50 a year after that. Franchisees make their money entirely from memberships; no surcharge is added to the goods sold through the club.

Although it is still tempting to think that there has to be a limit to what is new under the franchising sun, that limit has not been reached. There apparently is still plenty of room in the marketplace. ■

To order reprints of this article, see page 69.

Executive Pay: A Slower Rise

The performance of a company now has a demonstrable effect on how much money goes to its top managers.

By Edward T. Redling and Kevin Gorman

Compensation In 1986

	Chief Executive Officer		Chief Operating Officer		Top Marketing Executive		Top Mfring. Executive		Top Financial Executive	
Sales	**Salary**	**Bonus**	**Salary**	**Bonus**	**Salary**	**Bonus**	**Salary**	**Bonus**	**Salary**	**Bonus**
Under 10	131	56	88	19	63	14	55	8	50	11
10-25	123	64	113	62	67	19	62	17	65	14
25-50	142	54	119	46	81	21	67	17	75	20
50-100	169	57	132	41	89	20	80	18	84	20
100-500	226	98	174	73	107	31	99	28	114	39
500-750	306	157	229	108	129	46	118	39	137	48
750-1,000	356	165	260	112	133	32	127	39	155	64
1,000-5,000	434	223	316	148	193	50	160	41	197	86

Sales figures in millions of dollars. Salaries and bonuses in thousands of dollars.

Have you ever tried to make sense of the relationship between executive pay and company performance? It can be as frustrating as Pizarro's search for the lost Inca cities of gold.

Just when a pattern begins to develop, an aberrant year appears—a year in which profits plummet but executive pay skyrockets, or one in which profits accelerate off the graph but the rate of executive pay growth drops.

Where's the link?

Consider these mixed signals: Statistics showed that both American companies and their executives prospered in 1966; after-tax profits and total compensation to top executives increased 16 percent and 8 percent respectively. The next year was even more successful for companies, but compensation increased only slightly more than 5 percent.

In 1969, a 6 percent *decrease* in after-tax profits was "matched" by a 6 percent *increase* in the average executive's overall compensation and an 8 percent rise in the average bonus awarded. And in 1976, when net profits decreased 7 percent—plunging 21 percentage points from the previous year's level, which had been a 14 percent rise—total compensation for top managers grew a robust 7 percent.

Within the past decade, however, a cause-and-effect relationship between the performance of a company and its executive pay package has become more demonstrably evident. A close look at executive pay in 1986 reveals that the link is strong. Sluggish economic growth, mediocre profit performances and waning rise in the consumer price index—representing little inflationary pressure on top management compensation—resulted in the weakest increases in total cash compensation in years, according to the Executive Compensation Service's "1986/87 Top Management Report."

ECS surveyed more than 2,500 American companies and compiled data on over 50 different executive positions. The companies varied widely in type, location and size, with annual sales ranging from around $1 million to over $30 billion.

The survey shows that average cash compensation for top managers increased only 4.3 percent in 1986, lagging behind after-tax profits, which rose a modest 5.5 percent. That represented a 2.5 percent slide from 1985's average pay hike of 6.8 percent.

Even though those executives did not prosper as much as they had in the previous year, they still fared well against the consumer price index, which grew a negligible 1.6 percent in 1986. This meant a lead of 2.7 percent over the increase in the CPI and yielded a modest gain in real buying power.

Executives' salaries, the lion's share of the total compensation package, grew 6 percent—four percentage points lower than in the previous year and roughly in accordance with the national averages for all white-collar employees. For example, salaries of mid-

Edward T. Redling is president of Executive Compensation Service, Inc., of Fort Lee, N.J., a subsidiary of The Wyatt Company, an international consulting firm. Kevin Gorman is manager of the ECS "Top Management Report."

As Profits Go, So Go Bonuses

Year	Sales	After-Tax Profits	Salaries	Bonuses	Total Cash Comp.
1986	6.4%	5.5%	6.0%	3.3%	4.3%
1985	8.9%	16.5%	6.4%	8.7%	6.8%
1984	7.2%	8.8%	6.7%	8.4%	6.9%
1983	4.9%	(1.6)%	6.4%	(4.0)%	4.5%
1982	10.0%	11.1%	9.5%	11.1%	9.9%
1981	12.1%	12.6%	10.7%	12.7%	11.1%

Percentages represent increases (those in parentheses are decreases).

dle management personnel rose 6.1 percent in 1986 and those of first-line supervisors went up 5.6 percent. Bonuses, however, fell more than five percentage points from 1985's 3.3 percent average rise over 1984.

As American companies progressed into the second half of the decade, shareholders demanded a more direct link between company performance and upper echelon pay. The competitive advantages held by foreign companies—notably, inexpensive labor costs and favorable trade conditions—encouraged companies here to be more stringent in pay outlays.

But even when company profits were healthier, there was an increasingly widespread reluctance to simply put profits into the paychecks of top executives. Instead, larger portions of profits were rechanneled to fuel future growth. The number of executives who receive no raises in salary at all has risen each year. In 1986, 79 percent of executives got salary increases, down from 81 percent in 1984 and 84 percent in 1982.

Salary increases have ceased to be meaningful rewards or motivators for upper echelon employees.

On the basis of information supplied by companies surveyed, the increases are projected to be at about the same percentage level in 1987 that they were last year—which was slightly lower than in the previous three years and substantially lower than in the two years before then.

How, then, do companies motivate their top executives? With bonuses. Bonuses are today's principal rewards for upper management and represent a larger slice of the total compensation pie.

In 1971 bonuses accounted for 10 percent of cash compensation given to all top level personnel (with salary comprising the other 90 percent). Five years later they had grown to 15 percent, according to ECS survey figures. By 1986, bonuses made up a full quarter of the average cash compensation.

As might be expected, chief executive officers received the heftiest bonuses last year, averaging 46 percent of salary. Following close behind were chief operating officers, at 44 percent. Then came executive vice presidents and administrative vice presidents, at about 32 percent, and top marketing and sales executives, at 27 percent.

Energy companies awarded the largest 1986 bonuses of any individual industry—an average payment of 43 percent of salary. Public utilities came in last, with just 22 percent.

Perhaps the most variable components of the compensation picture have been executive perquisites, which continued to be integral components of compensation packages despite significant changes over the years. Even company cars and first-class airline tickets, sacred cows of perkdom, gave way to more constructive privileges.

The average cost of providing perquisites to a chief executive officer in 1986 was $24,025, according to the ECS "1986/87 Executive Perquisites Report." The report, based on a poll that asked about 48 perquisites at almost 500 companies, shows the cost of providing perks to other corporate officers averaged $17,558 each.

Not surprisingly, certain perquisites gained in popularity as others diminished. Since 1981, first-class air travel for chief executive officers has fallen almost 15 percentage points. Last year CEOs flew first-class at only 35.2 percent of companies surveyed—down from 38.4 percent in 1985 and from fully 50 percent in 1981.

Similarly, in 1983, 80 percent of companies provided cars to their CEOs (and allowed personal use of those cars). But in 1986 that figure dropped to 65.1 percent, a decrease of almost 15 points in only three years.

On the other hand, more modern benefits such as financial counseling services and personal computers are becoming popular. Over 10 percent of companies report providing PCs for home use to their CEOs—quadruple the percentage granting this perquisite in 1983.

Since a home computer can encourage after-hours and weekend work, both the company and the executive can reap the benefit of this perk.

Under current trends, salary increases to top executives are likely to continue to be proportionate to raises granted other employees, as companies press hard to contain fixed costs.

Bonuses will be the weather vanes that show how companies are really doing. Company profit performance will be the key to the size of executive compensation packages. The link is no longer missing.

Well, at least for now. NB

The Golden West

Chief executive officers at small and medium-size companies are apt to be best-paid if they are on the West Coast, according to a survey.

Growth Resources, Inc., of Peabody Mass., reports West Coast CEOs of such companies averaged 4 percent more in compensation last year than their counterparts in the central United States and 3 percent more than those in the East.

Generally, compensation of CEOs was 8 percent higher if their small or medium-sized firm was urban-based than if it was based in a more rural area, Growth Resources says.

You Tell Us

What ads caught your attention in 1986? Here is your chance to pick the best business-to-business advertising of last year.

BEST Business Advertising 1·9·8·6

The fastest. The brightest. The newest. The lightest. Every time you open a magazine or newspaper, or turn on the television, you are told: "Buy our product, and your business will have the winning edge."

Of the 1986 bombardment, which advertisements could best make you reach for your checkbook? Why do they stand out above the rest? Is it humor, drama, impact, a compelling story line or just plain good sense? Send in your ballot and tell us all about it.

This is your invitation to be a judge in the fourth annual *Nation's Business* Best Business Advertising Competition. As an executive with buying power, you can help make a difference in approaches to the marketplace.

To narrow the vast field of 1986's business-to-business advertising, a specially appointed nominating committee has selected outstanding messages in two categories—print and broadcast—that it thinks are most likely to have caught your attention last year. There are six television commercials and 13 printed ads.

To be eligible for a 1986 Best Business Advertising Award, the entries must have had a direct appeal to businesses—as distinct from consumers in general. The nominating committee had 15 members, all advertising executives and most from ad agencies. Each was permitted to suggest four ads—no more than one in each of the two categories originating from a member's own agency.

Once you have chosen your favorite from each category and mailed in the attached postage-paid card, your vote will be tallied with those of fellow *Nation's Business* readers. The winning companies and their advertising agencies will be announced in the April, 1987, issue.

Last year humor was the key to success in both print and broadcast ads. AT&T Information Systems and its agency, Ogilvy & Mather, hooked first place with an ironic print ad showing a little fish gobbling up a big one. *Nation's Business* readers reported that the ad, looking very much like an article, had useful information as well as amusing graphics.

AT&T's ad originally began as two separate messages. One had strong visual appeal and few words; the other was just the opposite. Because a test group of consumers warmed up to neither, AT&T persuaded Ogilvy & Mather to combine the two. The result? A real winner.

In the broadcast category, Federal Express and Ally & Gargano, Inc., reclaimed the top spot they had held two years previously. Whereas their first winner featured a lightning-fast talker to represent Federal Express' speedy service, the 1985 commercial showed the flip side. The ad showed intolerably slow competitors, sleepily mumbling their way through a business day—and competitors' customers, fit to be tied.

Says Nancy Altenburg, Federal Express senior manager of corporate advertising: "The 'hemming and hawing' commercial was created to introduce the first money-back industry guarantee of on-time delivery and a guarantee that, if you call us wanting to know the status of your package, we will get back to you within 30 minutes or you get your money back."

The Ally & Gargano creative team assigned to this campaign wanted to convey the company's competitive edge. "Other companies make claims to on-time delivery," says Denis Glennon, Ally & Gargano management supervisor, "but if an air express company won't provide a money-back guarantee, it should raise a question in the user's mind as to how much the air express company even trusts itself."

Runners-up last year included the Electro-Motive Division of GM (The Martin Agency, Inc.), Cigna (Doyle Dane Bernbach U.S.), Xerox (Needham Harper Worldwide, Inc.) and IBM Typewriters (Doyle Dane Bernbach U.S.).

This year's votes will be tallied by an independent Rockville, Md., company, Action Surveys. Six winners (first through third places in each category) will receive the distinctive *Nation's Business* scallop-shaped trophy—a widely recognized symbol of the people's choice in business-to-business advertising.

Don't put this page on your "To Do" pile! Scheduling is tight this year, so we need your ballot card immediately. You know what you liked in 1986. Now we want to know. Please pick up a pen, check off your votes and take a second to tell us why the ads you chose are your favorites. Your vote and your comments could make a difference in what you see in 1987.

Your opinions count, and we are counting on you. We will be looking for your card in the mail. NB

Nominating Committee

Jon Anderson
Senior Vice President/Manager of Creative Services
Colle & McVoy Advertising

Alan Barcus
Senior Vice President, Creative Director
D'Arcy, Masius, Benton & Bowles

Philip L. Bauer
Creative Director
Winston Advertising

Scott R. Crawford
Associate Creative Director
Howard, Merrell & Partners

Lou DiJoseph
Executive Vice President/Group Creative Director
Young & Rubicam, Inc.

Mike Hughes
Creative Director
The Martin Agency, Inc.

Jon Jacobson
Assistant Art Director
BBDO/Minneapolis

Walt Jaschek
Ad Manager
Southwestern Bell Telecom

Bob Jensen
Creative Director
Valentine-Radford Agency

Paula McDonald
Senior Vice President/Creative Director
McDonald Davis & Associates

Al Samuelson
Executive Vice President, Creative
Keller Crescent

John N. Siddall
Chairman
Siddall, Matus & Coughter, Inc.

Christopher M. Vernon
President/Creative Director
Andrews/Mautner, Inc.

Tom Weyl
Executive Vice President
Creative Director
Martin/Williams Advertising, Inc.

Chip Wimmershoff
President
Wimmershoff & Associates, Inc.

PRINT

BEST Business Advertising

1.

2.

3.

4.

1. **Employers Reinsurance Corporation**
   Valentine-Radford Agency
2. **Swintec Corporation**
   Wimmershoff & Associates, Inc.
3. **Barnett Bank**
   The Martin Agency, Inc.
4. **Honeywell**
   BBDO/Minneapolis
5. **W.R. Grace & Company**
   Howard, Merrell & Partners
6. **Southwestern Bell Telecom**
   Southwestern Bell Telecom
7. **3M File Management Division**
   Martin/Williams Advertising, Inc.
8. **Imagen**
   Winston Advertising
9. **AT&T**
   Young & Rubicam, Inc.

BEST Business Advertising

6.

5.

7.

9.

8.

PRINT

BEST Business Advertising

10.

11.

12.

13.

10. **Rolling Stone**
Fallon McElligott, Inc.

11. **Mosler, Inc.**
Keller Crescent

12. **Fannie Mae**
McKinney, Silver & Rockett

13. **Mortgage Guarantee Insurance Corporation**
McDonald Davis & Associates

BROADCAST

BEST Business Advertising

1. ADVERTISER: RIGGS NATIONAL BANK ■ AGENCY: SIDDALL, MATUS & COUGHTER, INC.

It was a real estate deal of astounding proportions: 500,000 square miles known as Alaska. In 1868, a Russian czar

owned it and the American government wanted it. But it was Riggs Bank that came up with $7,000,000

in gold to pay for it. Riggs leadership made the deal possible.

The same kind of leadership that makes Riggs what it is today.

2. ADVERTISER: IBM PC ■ AGENCY: LORD, GELLER, FEDERICO, EINSTEIN, INC.

Taking your business on the road can be a cumbersome task . . .

. . . and productivity can easily fall off. Presenting the IBM PC convertible. A powerful personal computer that easily

converts to a full function portable. One you can use in a plane, a car or a meeting, and be as productive . . .

. . . as you are at the office. The IBM PC Convertible. One computer for people who really need two.

3. ADVERTISER: MCI COMMUNICATIONS, INC. ■ AGENCY: D'ARCY, MASIUS, BENTON & BOWLES

We're MCI. Racing hard to be your communications company. We never coast. We're geared to win.

MCI competes internationally, offering you the world's most extensive range of voice, data and messaging services.

Our competition is good. We have to be better. And because we compete, you win.

MCI. Communications for the next 100 years.

4. ADVERTISER: AT&T INTERNATIONAL LONG DISTANCE SERVICE ■ AGENCY: YOUNG & RUBICAM, INC.

LARRY: Mario, Larry Wall from New York.
MARIO: Larry, did you get the sample of red silk? . . .

ANNCR. (VO): AT&T International Long Distance Service, lets you handle negotiations that would be impossible by

TELEX. So if you want to pick up your international business, pick up the phone.
LARRY: So when can you

send me this rare commodity?
MARIO: Tomorrow!
ANNCR. (VO): AT&T. The right choice.

Please turn the page for the final two broadcast nominees.

BROADCAST

BEST Business Advertising 1·9·8·6

5. ADVERTISER: FMC CORPORATION ■ AGENCY: THE MARTIN AGENCY, INC.

Let's say I'm a sunflower, and I was treated at planting with Furadan insecticide.

Now here's a sunflower who wasn't treated with Furadan. . . . You'd run right over a little guy like that.

So take some advice from a sunflower who knows. Use Furadan at planting.

It's the best way I know to keep your heads up. Furadan from FMC.

6. ADVERTISER: FEDERAL EXPRESS ■ AGENCY: ALLY GARGANO/MCA ADVERTISING, LTD.

MR. RELIABLE: Cleaver, did you send those galoshes to Cleveland? They didn't get there!

GUIDE: If you'd used Federal Express, you wouldn't be having this problem. . . . We have computers in our vans. . . .

and . . . we track every package and can tell you its exact status within 30 minutes or your money back.

ANNCR. (VO): Next time, send it Federal Express. Because all air express companies are *not* the same.

Please submit your vote for the Best Business Advertising poll by completing the postage-paid reply card provided.

Deadline for ballots:

February 10, 1987.

Berlin

In addition to being a major cultural center, West Berlin is the biggest industrial city between Paris and Moscow. Many affiliates or subsidiaries of American companies have expanded their operations in recent years. It has more research institutions than any other German city.

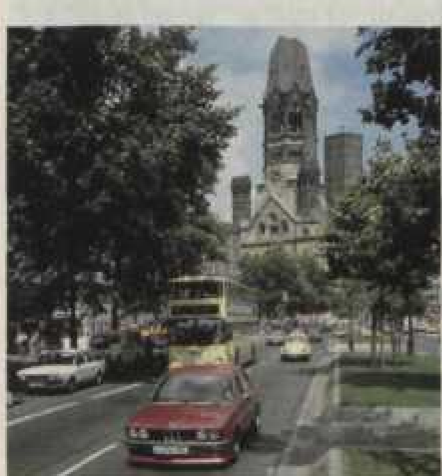

PHOTO: PRESSE UND INFORMATIONSAMT DES LANDES BERLIN

PHOTO: PRESSE UND INFORMATIONSAMT DES LANDES BERLIN

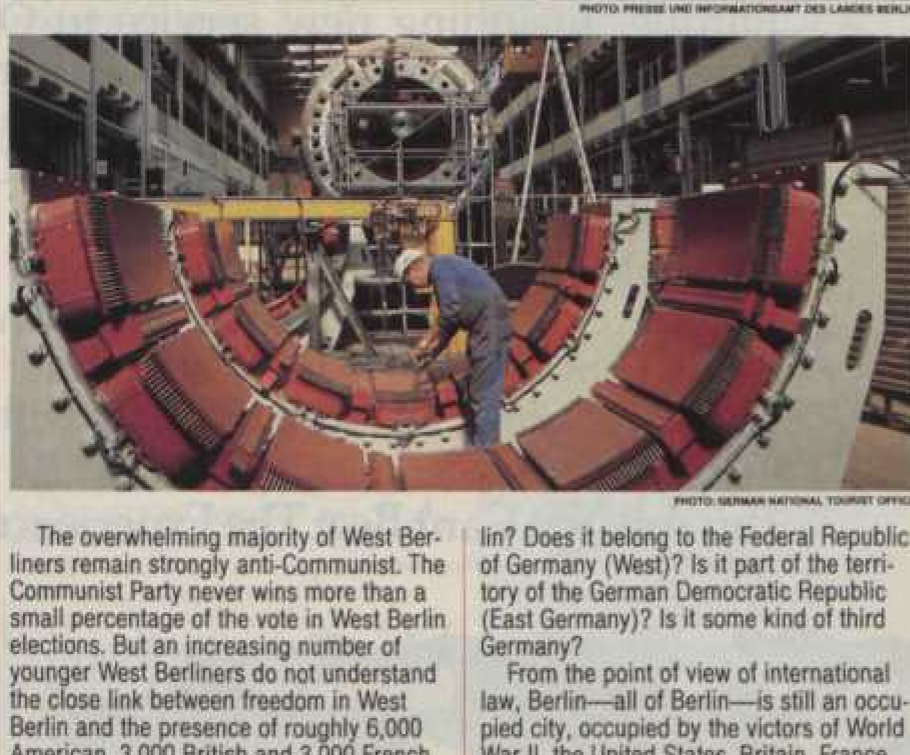

PHOTO: GERMAN NATIONAL TOURIST OFFICE

All through 1987, the two halves of Berlin will be celebrating the city's 750th anniversary. In a competitive frenzy in both parts of the city, international congresses, historical exhibits, artistic performances and unveilings of new or restored buildings have been planned. The 1987 Tour de France bicycle race will start in West Berlin; there will be giant Japanese fireworks, a rock festival in front of the Reichstag, the opening of a new chamber music hall next to the famous Philharmonic, a United States gala, and on and on.

Many dignitaries, including heads of government, will visit. President Reagan, Queen Elizabeth II and French President Mitterand have promised to come to West Berlin, so it is a safe prediction that Soviet General Secretary Mikhail Gorbachev will come to East Berlin.

Some observers in West Berlin are worried that the 750th anniversary festivities will tend to upgrade East Berlin and buttress its claim as a capital. Indeed the Communist regime there has spared no effort to spruce up East Berlin, which includes the former center of the city. Major historical public buildings like the Brandenburg Gate have been repaired and in some cases rebuilt in their original form. East Berlin does make a good impression on the casual visitor—but then there is a handicap that no propaganda, no posturing as a capital, can overcome: the Wall.

The overwhelming majority of West Berliners remain strongly anti-Communist. The Communist Party never wins more than a small percentage of the vote in West Berlin elections. But an increasing number of younger West Berliners do not understand the close link between freedom in West Berlin and the presence of roughly 6,000 American, 3,000 British and 3,000 French troops there. They chafe under some of the restrictions that the technical continuation of an occupied city status brings. To older Berliners, the blockade and airlift of 1948-49 changed the allied powers to "protective powers"; some of the young speak again of "occupation powers."

What exactly *is* the status of West Berlin? Does it belong to the Federal Republic of Germany (West)? Is it part of the territory of the German Democratic Republic (East Germany)? Is it some kind of third Germany?

From the point of view of international law, Berlin—all of Berlin—is still an occupied city, occupied by the victors of World War II, the United States, Britain, France and the Soviet Union. This is based on the London Protocol of the European Advisory Commission of Sept. 3, 1944. (France signed shortly after the end of the war.) The still valid declaration of the four powers of June 5, 1945, speaks of the four occupation zones of Germany and "a special Berlin area under joint occupation." Thus,

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B E R L I N

Berlin's historic public buildings are being spruced up for its 750th anniversary celebration this year. Entertainments, from fireworks to rock festivals, are planned.

PHOTO: OKON/LINDENBURGER—PETER ARNOLD, INC

Berlin formed a kind of fifth occupation zone and never was located in the territory of the German Democratic Republic, despite the claims of Communist leaders.

In practice, West Berlin is fully integrated into the legal, political, economic, social and cultural system of the Federal Republic. West Berliners do have a vote in the Federal Assembly (*Bundesversammlung*), which elects the President of the Federal Republic every five years. On rotation with the heads of other *Länder* (states)—Berlin, like Hamburg and Bremen, is a city state—the West Berlin mayor becomes president of the Bonn parliament's upper chamber for a year. As such he becomes the acting head of state when the President is out of the country.

Though the Soviets have—illegally, according to the allies—made East Berlin the capital of the German Democratic Republic, they have not abrogated two important aspects of the four-power status of the city as a whole. With their Western colleagues in the Air Safety Center in West Berlin, they jointly administer all airports in West and East Berlin. The Soviets and the GDR also continue to honor the right of all foreigners to go to East Berlin for 24 hours without a visa or any other permit. This, incidentally, makes East Berlin one of the tourist attractions of West Berlin—the only Communist territory in the world where you don't need a permit to enter!

Great benefits have accrued to the Berlin economy. Today, West Berlin's economy is as sound as that of the Federal Republic of Germany as a whole—and that surely is sound, indeed. West Berlin is still the biggest industrial city between Paris and Moscow; the major industries are electronics and electrical engineering, machinery production, chemical-pharmaceutical production, clothing, printing, food processing and tobacco.

Because West Berlin is cut off from the West German economy and suffers various economic disadvantages from its location as an island within Communist territory, it has to be subsidized by the West German government. Apart from other forms of subsidy, this works through an array of financial incentives. In addition to investment grants, low-interest loans and reduced taxes, Berlin offers a unique turnover bonus that can add up to 14.2 percent of sales to a company's pretax profit.

The Berlin Economic Development Corporation, created to promote investment in West Berlin (it has offices in New York, Atlanta, Boston, Dallas and San Francisco), has attracted almost 300 new companies to the city. There are 31 affiliates or subsidiaries of American companies in West Berlin, responsible for 10 to 15 percent of Berlin's yearly industrial trade and investment figures. Many, like Ford and IBM affiliates, have expanded their operations in recent years. Other U.S. companies include General Motors, ITT, Kaiser Aluminum, Bally and United Technologies. Pan Am carries the bulk of air passengers to and from West Berlin. Under the postwar arrangements, only airlines of the three allied powers are allowed to fly to West Berlin.

Next to Vienna, West Berlin offers the best East-West trade services: banks, trading enterprises, consulting and engineer-

B E R L I N

ing offices, transport firms and insurance companies specializing in this area.

The completion of a giant convention complex, the International Congress Center—the ICC—has enabled West Berlin to become the sixth largest center for conventions in the world, up from 14th place in 1977. For the last three years in a row, Conferences and Exhibition International has named the ICC "best convention center of the year." Since its opening in 1979, 3 million visitors have participated in events staged at the ICC.

West Berlin has two big universities and 160 research institutions—more than any other German city.

Because of its infrastructure, and energetic promotion by the city government, West Berlin has become a center of electronic and electro-technical development. Thus, together with the Technical University, the city government created an Innovation and Founders' Center, known as BIG (for *Berliner Innovations- und Gründerzentrum*) where young entrepreneurs can find reasonably priced premises and—because so many enterprising businessmen and technologists have been brought together—a stimulating atmosphere. BIG has been such a success that a second center of this kind is in the works.

A decline in the German birthrate has been offset by an increase in guest workers, who now are more than 10 percent of West Berlin's population. The largest group, the Turks (whose 120,000 people make West Berlin the world's fourth largest Turkish city) pose special problems.

Also, the Berlin economy, like that of West Germany, is burdened with a 10 percent unemployment rate—though joblessness is not as extensive as it was a few years ago.

But today the prevailing mood among West Berliners is ebullient, and from the standpoint of overall quality of life, most observers would rate West Berlin at the top of the list of German cities. West Berlin remains a showcase of freedom inside the Communist world and a barometer of East-West relations. That alone will ensure its continued special importance. NB

Those Burgeoning Worker Benefits

They come to roughly $4 for every $10 in pay, and they have begun to grow more rapidly—a matter of concern for every American employer.

By James R. Morris

Employers are paying record amounts to provide a wide range of benefits for their employees. The average cost per hourly worker topped $8,000 in 1985, according to a U.S. Chamber of Commerce survey.

Benefits for workers paid by the hour have been surveyed by the Chamber since 1947. In 1985 they amounted to 37.7 percent of gross payroll, which includes pay for time not worked.

Time not worked but paid for—vacations and so forth—has been part of the traditional measure in these surveys. A new measure relating benefits only to pay for time actually worked puts the cost of benefits at 43.4 percent of pay.

The growth of employee benefits, which had been slowing in previous years, accelerated in 1985:

	Average payment per employee	Percentage increase
1980	$6,084	9.4%
1981	6,627	8.9
1982	7,187	8.5
1983	7,582	5.5
1984	7,842	3.4
1985	8,166	4.1

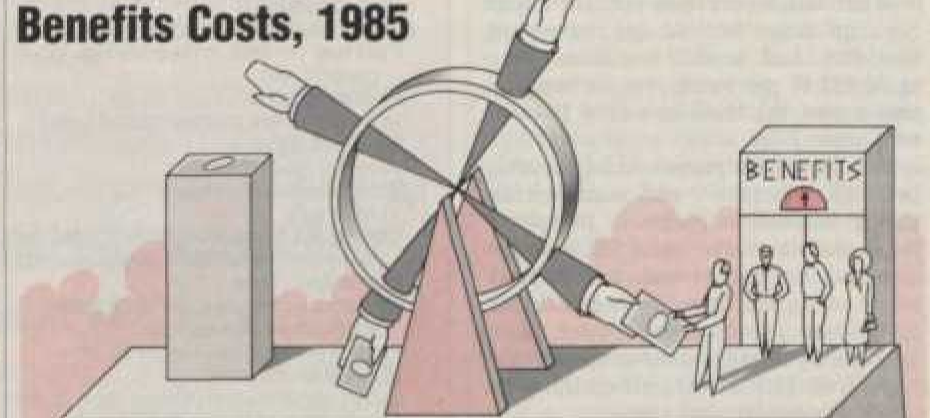
Benefits costs rose 105 percent from 1975 to 1985, while average weekly earnings increased 92 percent. In 1985 benefits were 4.1 percent above the year before, while earnings were up only 0.9 percent.

The U.S. Chamber's benefits surveys cover hourly rated workers in almost all the private sector—agriculture is the principal exception—and a small segment of the government sector. There were 1,000 respondents to the latest survey, nearly two thirds of them medium-sized or large companies. The survey data covered more than 5 million employees nationwide.

For *all* employees in the nation—salaried as well as hourly rated, in all industries and in the federal, state and local governments—the total cost of employer-paid benefits in 1985 is estimated at $691 billion by the Chamber's Research Center. A preliminary estimate is that the figure will be $735 billion in 1986.

James R. Morris is an economic consultant and former director of survey research for the U.S. Chamber of Commerce.

Weekly Employee Benefits Costs, 1985



	Per Employee
All industries	**$157.04**
Manufacturing:	
Petroleum Industry	236.60
Primary metal industries	218.15
Chemicals and allied products	193.96
Transportation equipment	185.56
Machinery (excluding electrical)	180.92
Fabricated metal products (excluding machinery and transportation equipment)	166.52
Electrical machinery, equipment and supplies	164.87
Food, beverages and tobacco	162.02
Rubber, leather and plastic products	155.67
Pulp, paper, lumber and furniture	149.73
Stone, clay and glass products	144.44
Printing and publishing	140.23
Instruments and miscellaneous manufacturing industries	133.62
Textile products and apparel	88.44
Nonmanufacturing:	
Public utilities (electric, gas, water, telephone, etc.)	204.27
Miscellaneous nonmanufacturing industries (research, engineering, education, government agencies, construction, etc.)	148.67
Insurance companies	146.31
Hospitals	129.71
Banks, finance companies and trust companies	126.00
Trade (wholesale and retail other than department stores)	109.56
Department stores	82.54

CHARTS: DALE GLASGOW

There are two major kinds of benefits in the hourly employee survey:

- Nonwage outlays for insurance premiums, Social Security taxes, private pensions, unemployment and workers' compensation taxes, profit sharing and similar benefits. They averaged $103.26 per employee per week in 1985.
- Wages paid for time not worked, including vacations, holidays, sick leave and rest periods. They averaged $53.78 weekly.

Of the many benefits covered in the report, the six most costly were: insurance, Social Security, vacations, private pensions, paid rest periods and paid holidays.

Together these benefits cost employers an average of $121.26 per week per

employee—more than 77 percent of total benefits.

Employer payments for life, hospital, surgical and medical insurance averaged $30.02 per employee per week, of which only about 10 percent was for life coverage. These costs increased 168 percent in the 1975-1985 period.

What employers laid out for Social Security taxes for old age, survivors, disability and health insurance averaged $27.46 per employee per week. It was a cost that had increased 125 percent since 1975.

Benefits costs varied widely among both manufacturing and nonmanufacturing industries. Firms in the petroleum industry averaged $236.60 per week per employee, while textile products and apparel firms averaged $88.44. In the nonmanufacturing sector, average weekly benefits costs ranged downward from $204.27 for public utilities to $82.54 for department stores.

Not only did benefits costs vary widely by industry, they also varied by company—often within the same industry. Seventeen firms reported average weekly costs of less than $68, while at the other extreme, 51 companies spent an average of more than $250.

The cost to employers of private pensions averaged $17.40 weekly per employee in 1985. Pension costs per employee have been declining since 1982, when they peaked at $20 per week.

One explanation for the decline is the cancellation of pension plans by many companies as successive new laws added administrative burdens for them in the pension field.

Another explanation is the stock market boom, which raised values of pension fund assets high enough and quickly enough to sometimes enable companies to skip contributions.

Only eight of the 1,000 responding firms reported no payments for insurance, but 217 reported no payments for pensions.

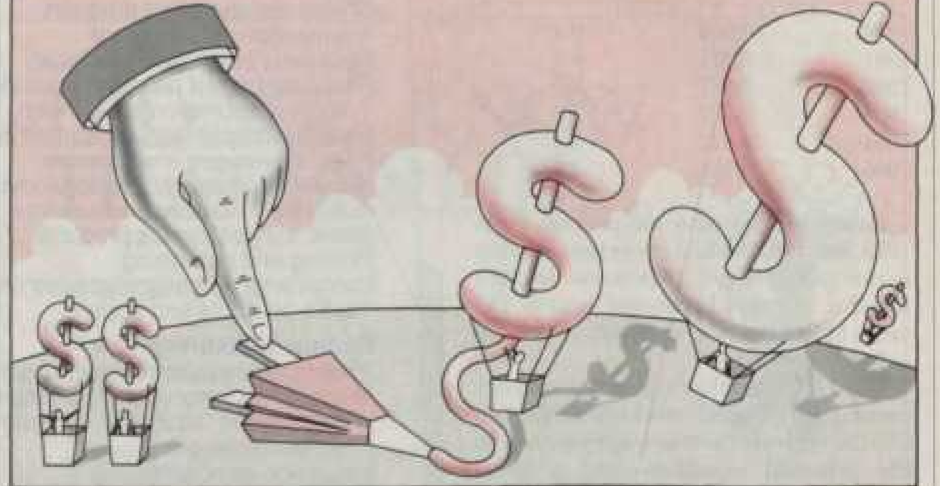
Paid vacations cost employers an average of $20.17 per week per employee in 1985. Paid rest periods, coffee breaks, etc., cost an additional $14.46, while paid holidays came to $11.75, and sick leave added $5.50.

A supplemental survey of 700 firms found that fully 77 percent of responding firms provide parental leave. At half of these firms, the leave is unpaid; the other half make it paid. This benefit is either given on an informal case-by-case basis (27 percent), through a formal plan (19 percent) or through integration into other sick and annual leave plans (31 percent).

There is a drive on Capitol Hill for legislation requiring up to 18 weeks' leave for employees with newborn or sick children—or with sick, elderly parents—and up to 26 weeks' disability leave. Many business people fear that the legislation's enactment ultimately would lead to a requirement for paid leave. And that, they say, is something they do not need—certainly not in the light of the cost growth figures turned up in employee benefit surveys. ■

How Benefits Have Grown

Per Employee, Per Week	1975	1985	Percentage Increase
Insurance (life, hospital, surgical, medical, etc.	$11.19	$30.02	168%
Old age, survivors, disability and health insurance	12.23	27.46	125
Paid vacations	11.15	20.17	81
Pensions (nongovernment)	11.92	17.40	46
Paid rest periods, coffee breaks, lunch periods, etc.	7.85	14.46	84
Paid holidays	7.23	11.75	63
Unemployment compensation taxes	2.19	6.62	202
Paid sick leave	2.58	5.50	113
Workers' compensation	2.71	5.02	85
Profit-sharing payments	2.37	4.50	90
Thrift plans	0.60	2.52	320
Other paid nonworking time (guard duty, death in family, personal emergencies, etc.)	0.90	1.90	111
Dental insurance	0.21	1.67	695
Christmas or other special bonuses, suggestion awards, etc.	0.90	1.33	48
Employee education expenditures	0.23	1.21	426
Short-term disability	N.A.	1.17	N.A.
Salary continuation or long-term disability	0.44	0.85	93
Employee meals furnished free	0.40	0.56	40
Discounts on goods and services purchased from company by employees	0.35	0.33	−6
Other employee benefits	1.17	2.60	122
Total employee benefits	**$76.62**	**$157.04**	**105%**
Average weekly earnings	**$216.42**	**$416.02**	**92%**



For More Information

Employee Benefits, 1985, a 36-page report that contains special new sections on parental leave benefits and continuation of health benefits after layoff or termination, can be bought for $20 a copy from Publications Fulfillment, U.S. Chamber of Commerce, 1615 H Street, N.W., Washington, D.C. 20062. Copies can also be ordered by telephone: (301) 468-5128.

Computerizing With Confidence

part 4

By Karen Berney

"All right, class, we are going to construct a spreadsheet in Lotus 1-2-3," announced the instructor. The four of us, who had paid $50 each for a three-hour introductory course on manipulating grids of rows and columns, hunched over our keyboards as he rattled off a string of commands: "Hit the slash key! Get into the Lotus menu! Press enter! Select the worksheet option, set a range and format the numbers into dollars."

As we hastened to keep up, pounding the keys, numbers popped into the cells—spreadsheet talk for the positions where rows cross columns on the worksheet. Step by step, we filled a chart with Commerce Department data on domestic lumber production and consumption for the last eight years.

Our confidence level was rising when a classmate abruptly called our attention to his computer screen. "Hey, the darn thing just quit on me," he cried. Sure enough, all his work had mysteriously disappeared. In the upper right corner of the screen a message was flashing: PARITY ERROR ON ????

Conceding that "I'm no hardware engineer," the instructor informed us that the microcomputer was down and that the other student, Charles Leveille, would have to team up with me on a healthy IBM PC-XT. The inconvenience did not perturb Leveille, an accountant who had mastered several software programs thanks to how-to computer courses. He had experienced worse. "In the last class I took, in Atlanta," he said, "I had to use a modem to tap into a computer database in California. Every time I dialed the number, the phone line went dead. It took three days to straighten out the problem."

The rest of the lesson, conducted by a moonlighting trade analyst in partnership with a Washington graphics firm that rents out its computers after hours, went smoothly. We learned how to create Lotus formulas that churn out averages, means and standard deviations, and we practiced basic chores like "copy," "move" and "file." As the session came to a close, my colleagues were bleary-eyed but raring to sign up for the next week's intermediate class. "This was much more efficient than working by trial and error from the manual," said one. "There was a significant amount of content packed into three hours, and you can't beat the price," added another.

New computer users should avoid training courses that downplay theory in favor of hands-on, instructor-led button pushing, say experts.

ILLUSTRATIONS: JERRY DADDS—EUCALYPTUS TREE STUDIO

There are many types and levels of computer training, and, as I discovered, there is no one-size-fits-all approach. My three classmates, all with marching orders from their bosses to learn Lotus 1-2-3, were savvy computer users. They knew exactly why they needed Lotus and were merely seeking shortcuts to accelerate learning that would truly begin after class when they practiced on their own. What seemed to me like three hours of instructor-led button pushing met their expectations completely. Explained my terminalmate Leveille: "We are here to learn the nuances, the tricks of the trade, from an expert."

Regardless of how computer-literate your employees are, they will need some sort of self-paced or formal training to use unfamiliar software programs. "Training is the investment you make in people so hardware and software pay off," says Susan Boyd, director of PC Concepts, a Philadelphia training firm.

But training is not cheap. Boyd says a software package costing $600 could require an expenditure of $200 to $400 per person for classroom training.

Nor is it quick. Nine to 12 hours of instruction are generally required to become well versed in the commands and features of Lotus 1-2-3, says John Krout, who teaches spreadsheet classes at the Executive Computer Training Center in Washington. Even then, the average beginner needs another 30-40 hours of practice in order to take full advantage of the program.

Say you have a dozen employees. You can spend from $50 (for a computer training disk all can use) to $50,000 (for a company-tailored program) on training. The method or mix of methods you choose will depend on the users' levels of experience, the size of your budget and how quickly you need to get a software program up and running.

Highly motivated people may opt to teach themselves through a combination of manuals, books and disk tutorials. This approach will not strain your budget; manuals are included in the price of the package, and an increasing number of programs come with built-in tutorials that you use on the computer.

Self-starters who succeed often become resident experts leading colleagues into new frontiers by example and personal coaching. Strouse Greenberg & Company, a small commercial real estate agency in Philadelphia, sends new employees to a two-day training course. If they have problems back on the job, they can turn to two officemates who have voluntarily assumed the roles of in-house computer gurus and troubleshooters.

"We found that there is always someone in the organization who will read every page of the manual, stay until midnight and turn into a real computing advocate," says Steven Kessler, the firm's senior vice president. "You know the type. It's the one who runs excitedly down the hall saying, 'Look at this sales report. I did it on the computer in just two hours.' "

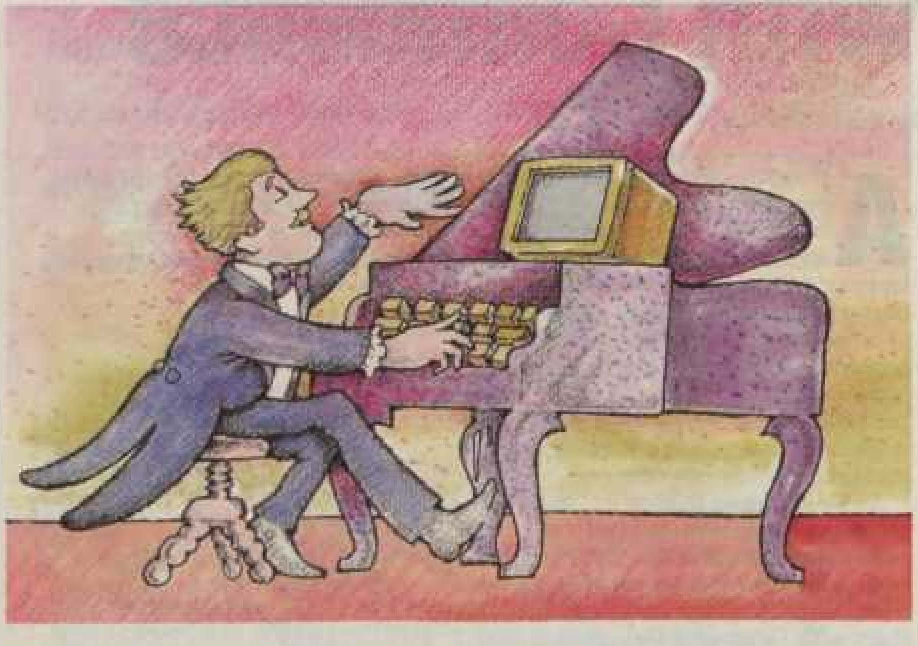
While low in cost, such learning can be painfully slow. Ralph Ganger, president of CES Training Corporation, Paramus, N.J., says numerous studies show that the average self-taught Lotus user requires 80 hours to master

Using computer software to its full potential is like becoming a great pianist. You do not just sit down and start playing the classics. You have to practice for hours on end to master any one piece of music.

the program. Unless your employee owns a computer and is willing to study at home, that is valuable time away from the job, Ganger points out.

Furthermore, experts say independent learners often stop at a plateau and need additional training to achieve higher levels of sophistication.

The tools for self-study, however, are changing for the better. Until recently, training programs built into software were exercises in "electronic page turning," says Susan Boeschen, director of user education at Microsoft Corporation, Redmond, Wash., which bundles software in two of its commercial packages for word processing and project management. Instead of reading a text in a book, the user scrolls through it on a screen, which Boeschen says is far more tiring.



Today's computer-based training programs draw on the power of the PC to make the learning experience more interactive and intuitive. The programs use plainer English, simulation and graphics, and give prompt, meaningful feedback.

"We think interactive computer training is the quickest way to get up to speed and acquire self-confidence at your own pace," says Boeschen.

Microsoft's latest offering is Learning DOS, a program that teaches you how to use DOS commands. DOS is the disk operating system used on IBM or IBM-compatible PCs; knowledge of basic DOS commands is important for using applications programs.

For Lawrence Atherton, an instructional systems specialist at San Diego's Mesa College, Learning DOS could not have arrived a moment too soon. So frustrated was he with the state of computer learning tools that he was about to assign a staff team the task of writing materials and software to teach PC basics.

The Microsoft program "has saved us an awful lot of time and money," says Atherton. It has alleviated demand for PC literacy training, "leaving instructors more time to focus on people with special applications needs."

First-time users of the program are enthusiastic about being able to control the content, amount and pace of their learning—a luxury not afforded in a classroom situation, notes Atherton. Even those who already knew how to use DOS are saying they have learned something new, he says.

Another low-cost training option is an audio cassette. Marilyn Allendorph, National Can Corporation's education coordinator, says her goal was to minimize training time and costs for hundreds of the firm's employees. "Sending everyone to school would have been too expensive," she explains. Because the Chicago-based company uses an unusual computer operating system, existing software training packages would not have worked.

Thus, when Allendorph saw an ad in a trade magazine describing audio training from Fliptrak Learning Systems, Glen Ellyn, Ill., she investigated and found "it was exactly what I was looking for." She bought four audio programs on the Wordstar word processing package, each program made up of three 2½-hour tapes, for the bargain price of $300.

To date, 250 people have graduated from the course, which, Allendorph says, now "only costs the company their time away from the job"—a total of 40 hours over a six-week period. Though a strong proponent of independent learning, Allendorph says it does not remove the need for support by other people. "We supplement audio training with a weekly one-hour roundtable where employees can review what they have learned and how to apply it," she reports.

Some people adapt well to self-study; others may need the familiarity and security of a live classroom. Says PC Concepts' Boyd: "Most of us have been conditioned not to learn on our own, let alone from a computer. We are products of the classroom environment."

Instructor-led training courses span a wide spectrum. You can expect to get what you pay for. For example, in the $50 class I took, prior experience with computers was assumed as well as theoretical background in financial analysis. Course materials consisted of a 12-page handout listing Lotus commands.

For twice the price I could have attended a four-hour session at a professional training institute and walked away with my lessons stored on a computer disk and a thicker handout. Just as easily, and for $75 to $125, I could have enrolled in an evening adult education class at a local college.

Taking a workshop at an outfit like PC Concepts, where instructors are professional teachers and source material can run hundreds of pages, costs $225 for one day and $395 for two.

PC training firms have not yet formed a national organization, so you should consult ads in your local newspaper to find out about vendors in your area. Be sure to evaluate their qualifications. Boyd offers the following tips:

- Look for accreditation. Accreditation from a professional society, or authorization from the software publisher, guarantees that course content has been formally reviewed and approved.
- Evaluate the staff's background. Technical experts masquerading as teachers make the worst instructors, says Boyd.
- Review course design, materials and facilities. A well designed course includes written objectives and practice lessons based on real world problems.

Newcomers especially should avoid courses that downplay theory in favor of instructor-led button pushing. Materials should be current with the software manual and serve as a handy reference. Classes should be small—no more than 12 students, with a maximum of two to a computer.

One limitation to training methods—from the least formal to the most: They teach via hypothetical cases that may have no relevance to your business. "That can make it difficult to immediately apply the training on the job," says CES Training's Ralph Ganger.

Mark Wey, a marketing manager at Dennison Manufacturing Company in Framingham, Mass., was seeking to optimize the firm's product mix. He wanted his staff trained in using Lotus 1-2-3 to forecast how changes in the mix would affect production costs and market share. A screening of some university-sponsored Lotus classes around Boston convinced him they were not adequate.

Wey entrusted the training of his staff to MicroMentor, a Cambridge, Mass., firm that specializes in customized software training.

A MicroMentor team spent months talking to Dennison executives and analyzing the firm's competitive strengths and weaknesses to gather material for a series of case studies. These became the curricula for teaching employees how to use Lotus. To Wey, the difference was between "giving my staff a generic experience and one that addresses issues valid to our business."

Customized training is high quality, with a cost to match. MicroMentor charges $10,000 to design one electronic case and $500 per person per day to deliver the training at the customer's premises. The firm charges a much more modest $350 a day at its headquarters for personal instruction and hands-on experience in applying software to cases in a specific industry.

If you pool resources with others in your line of business, CES Corporation will provide a training program at a group rate. Currently it is designing two-day sessions for a group of insurance agencies and members of a local association of financial planners. CES plans to bill the groups $1,000 per day to teach a class of 10 to 12 people. That works out to $200 per participant, compared with $400 if you sign up alone.

Recognizing the advantages of customization, makers of software tutorials may soon offer products containing industry-specific examples.

No matter what type of training you choose for your employees, you can help them gain the most from the experience by supporting follow-up—reading, participation in users' groups and, most important, practice. "Remember," says Boyd, "what you do not use, you lose." NB

Next: How you can grow with your computer.

To order reprints of this article, see page 69.

Mishaps That Mothered Invention

By Bob Gatty

***Nation's Business* is observing its 75th anniversary in 1987 with an anniversary issue in September and special articles like this one in other issues.**

PHOTO: STEVE WOIT—PICTURE GROUP

3M chemists Samuel Smith and Patsy Sherman saw product possibilities when a laboratory fluid, unintentionally dropped on a sneaker, kept the shoe free of soil and stains. The result: Scotchgard.

Children around the world today try to figure out new ways of playing with the Slinky, that bouncy coil of wire that hops, skips and jumps with the slightest push. When you look at the thing, you might wonder: Who on earth dreamed up a product like that?

Actually, it was dreamed up on water. In 1943, during World War II, Naval Engineer Richard James was on a new ship's trial run. A torsion spring fell off a table and bounced. James picked it up, dropped it deliberately. It bounced again. When he got home after the voyage, he told his wife, Betty, about the incident. "I think I can do something with this," he said. "I think it will make a good toy."

James obtained a patent, and in 1945 he and Betty went into business. But nobody wanted to buy the toys, Betty James says today. "Then we took 400 of them one evening to the Gimbel's store in Philadelphia. They were in rolled-up sheets of paper with the instructions, not even any boxes. We put them on the edge of a table and knocked them off. We sold 400 in 90 minutes."

Since then, James Industries, Hollidaysburg, Pa., has sold millions of Slinkies. Betty James, now 68 and a widow, has run the company since 1960, raising six kids in the process. How much money has the Slinky produced since that evening at Gimbel's? She replies with a laugh: "Let's just say, enough."

The Slinky's story stems from Richard James' capitalizing on a mishap—seeing in a bounce after an accidental fall the potential for a new product.

Wendell Dunn, an invention buff who teaches a Wharton School M.B.A. course in entrepreneurship at the University of Pennsylvania, says it was not "invention by mistake," but "invention by serendipity" or "invention by happenstance." Dunn, a former president of the American Society of Inventors, says ability to recognize the value of the unexpected is essential to the success of invention after invention.

The Kellogg Company, Battle Creek, Mich., was born in 1894 when Dr. John Harvey Kellogg, superintendent of the Battle Creek Sanitarium, and his brother William Keith Kellogg, the hospital's business manager, were experimenting with boiled sheets of wheat. Unexpectedly called away from their laboratory, they made a startling discovery on their return the next day: Wheat dough, when placed between rollers, no longer came out in sheets, but broke into small flakes. Four years after the creation of flaked ready-to-eat cereal, the brothers marketed what would become America's best-known breakfast cereal—Kellogg's Corn Flakes.

Coca-Cola was developed in 1886 by Atlanta pharmacist John Pemberton, who was concocting a headache remedy. Rather than helping soothe pain, it turned out to help to soothe a thirst.

Scotchgard, a 3M product, is the world's top-selling protective finish for textiles, carpeting and leather. It has been adapted for wood surfaces and is turning up on wood furniture.

It all began in the 1950s at the 3M Center in St. Paul, Minn., when a laboratory assistant spilled a substance being developed for aircraft use. Fluid landed on one of her canvas sneakers. She noted not only that it was almost impossible to remove, but also that the wet canvas resisted soil and stains and stayed cleaner than the rest of the shoe. Patsy Sherman and Samuel Smith, chemists in the lab, thought there were product possibilities in the fluid, and research convinced them.

They are Scotchgard's co-inventors. Spurred by their findings, 3M established a program to develop the substance's capabilities and in 1956 launched it commercially. At first its use was limited to apparel, rainwear and upholstery. Today more than 25 formulations are used in manufacturing or by the consumer.

Crucial to Scotchgard's success was the ability of Sherman and Smith to see the product potential when that chemical was spilled on the lab assistant's shoe. Without such perceptiveness, there would be no Scotchgard for carpets, for furniture, for clothing, for anything.

The same is true of another 3M product, Post-it Notes. Spencer Silver, a 3M

Some of the most successful products in history have resulted from mishaps that meant opportunity to creative thinkers.

scientist, was looking for a superstrong adhesive in 1970. Instead of coming up with one, he developed an adhesive that was superweak. Nobody could figure out what to do with such a glue until one 1974 Sunday when Art Fry, a research chemist colleague of Silver's, was singing in the choir at St. Paul's North Presbyterian Church.

Fry always had a heck of a time keeping his place in the hymnal. He would mark the pages with little slips of paper before the service began, but some would always fall out—so that when he got up to sing, he couldn't find his songs. This time, Fry got to thinking about Silver's glue that would just barely hold a piece of paper to another. Why not use it for bookmarks?

He made samples, daubing them with some of Silver's glue, and used a couple for notes in which he explained his idea to his 3M colleagues.

"Then it dawned on us," Fry recalls, "that the broad application was for notes—not bookmarks." Fry papered colleagues at 3M with samples, drumming up support, and by late 1975 the product was an in-house hit.

"We had to work out some bugs," Fry recalls. For example, when the paper was stuck down and then lifted up again, some glue stayed behind. "That was one reason people didn't like it in the beginning," Fry says.

By 1977, manufacturing techniques had been worked out, and Post-it Notes were test-marketed in four cities. The product flopped. But 3M marketing experts noticed that in areas where office supply stores offered samples, Post-its sold well. So in 1978 Boise, Idaho, was blitzed with introductory dealer kits, heavy advertising and personal sampling. There were immediate results.

"Not since we introduced Scotch Brand Magic Transparent Tape more than 20 years ago have we had a product that is so simple, yet so amazingly versatile," says Chuck E. Harstad, vice president of 3M's commercial tape division.

Fry acknowledges today that the product succeeded because 3M people not only were able to recognize its potential, but also to effectively market it.

That, says Dunn, is where all too many inventions fail. "Inventors come up with a product, but they can't carry it through," he explains. "It takes very different kinds of people to develop a new product and then find a place for it in the marketplace."

For Betty James, a torsion spring's accidental bounce has led to sales of millions of Slinkies.

Dunn likes to tell the story of GORE-TEX, an expanded use of Du Pont's Teflon. In 1958, W.L. Gore resigned from Du Pont, where he headed operations research. The company had decided against getting into end-use aspects of Teflon, and he wanted to spend full time developing uses for the product. He set up shop with his wife in the basement of his house in Newark, Del., to develop interconnecting wiring for computers and other electronic devices using Teflon as the insulation.

Gore's son, Bob, who went to work for his dad after getting a Ph.D. in chemical engineering, spent months in 1969 slowly and painstakingly stretching and pulling Teflon—trying to create a strong filament capable of being woven. One day, frustrated, he jerked a rod of extruded Teflon, intending to break it. Instead of breaking, it stretched and became strong and porous. That was the key to making expanded Teflon, now called GORE-TEX.

Computer signals travel up to 90 percent of the speed of light on GORE-TEX fibers—compared with 70 percent on solid Teflon—increasing data processing capacity. Microwave guides using the product are being made for satellite communication and in defense systems to produce laser beams of microwave energy. Placed in the human body, GORE-TEX reduces rejection reaction, thus increasing the success of implants of artificial arteries and ligaments and of catheters. GORE-TEX fabrics are used in rainwear, skiing clothes and running wear.

The base product, Teflon, was also discovered serendipitously—in 1938 at a Du Pont laboratory—by Roy J. Plunkett, who was named recently to the National Inventors Hall of Fame.

Plunkett was experimenting with gases to find a new fluorocarbon refrigerant. He and his associates noticed that gas in a cylinder that had been stored in dry ice had polymerized spontaneously into a white, waxy solid. Further testing showed that the solid was resistant to practically all chemicals, was not affected by temperature extremes and was extremely slippery.

"It did not occur to me right away what possibilities the material might have," says Plunkett. "That had to wait for some lab tests."

Today Teflon fluorocarbon resin is used in cookware, wire insulation, automobile gaskets, space suits, even in buildings. The Pontiac Silverdome, home of the National Football League Detroit Lions, has a 10-acre glass fabric roof covered with Teflon. New York City's subway cables are insulated with Teflon.

"Frequently," says the Wharton School's Dunn, "somebody will be in a situation where something doesn't work the way it's supposed to. Then he starts thinking, 'I could do this with it or that with it.' Sometimes, that's where it all begins." NB

To order reprints of this article, see page 69.

Personal Management

Innovators

By Sharon Nelton

ILLUSTRATION: GREG FITZHUGH-EUCALYPTUS TREE STUDIO

Advice To Women

Get rich, Washington stockbroker Julia Montgomery Walsh advises women.

She qualifies that by saying that women should not seek to be "rich rich," necessarily, but they should strive to be at least comfortable.

One Christmas, Walsh, who is managing director of the Julia M. Walsh & Sons division of Tucker Anthony & R.L. Day, Inc., gave her women clients pillows embroidered with the words, "Rich is better."

At a recent meeting of the Babson Women in Business at Babson College, she said there are three reasons why the motto on the pillow is especially true for women:

1. "It allows women options: It allows you to change jobs. It allows you to move. It allows you to leave your husband, if you want to."

2. "It gives you power within your community—power to contribute, power to participate, power to go to the things you might not go to if you couldn't afford it."

3. "Probably most important of all, [being rich brings] peace of mind. I don't think there's anything that drives you battier than a tight budget." Being poor, says Walsh, "really is the worst thing in the world for optimism and enthusiasm."

Clone Your Ads

KSK Communications, Ltd., advises you to obtain reprints of your ads, because they offer an inexpensive way to increase advertising effectiveness. The McLean, Va., company, founded by Karen Syence Kennedy, specializes in advertising and public relations for technology firms.

According to a recent KSK newsletter, you can do the following with reprints of your ads:

- Enclose a copy in your pay envelopes as a way of keeping employees informed.
- Use them as handouts at trade shows.
- Include them in informational packets on your firm.
- Frame them and display them in your lobby, conference rooms, cafeteria, manufacturing area and managers' offices.
- Mail copies to your sales force before the ad appears, along with your advertising schedule. This keeps salespeople informed *before* prospects start to call.
- Send copies to your prospects, perhaps with a note that says, "I thought you'd like to see this advance copy."

KSK advises getting an extra set of film made for the reprints when you are having your ads produced. "And don't hesitate to order a *large* quantity of reprints; 10,000 copies of a full color ad cost less than half again more than only 1,000 copies."

Dealing With The Problem Boss

Do you get enough feedback on your performance as a manager from your employees? No? Maybe you are a "problem boss." Consider movie mogul Sam Goldwyn. According to Peter Wylie and Mardy Grothe, authors of the new book, *Problem Bosses* (Facts on File), Goldwyn once said, "I don't want any yes men around me. I want people who tell me the truth even if it costs them their jobs."

He was just kidding, but his words illustrate one problem of some problem bosses: They live in a "feedback vacuum," because they don't really tolerate being told the truth by employees.

Employees everywhere complain of bosses who are incompetent, neurotic, slobs or just plain impossible. Wylie and Grothe, partners in Performance Improvement Associates, a management consulting firm based in Boston and Washington, say such bosses represent a very real problem. They often are bad bosses because they have poor role models, don't get good training, are no good at handling power and are not always held accountable by *their* bosses, Wylie and Grothe say. And being a boss is a tough, tough job.

What can you do about it if you are the employee? The authors offer a dozen detailed strategies, from doing nothing to "firing" the boss—in other words, quitting. Wylie and Grothe say they prefer the word "firing" because it is more positive. "If bosses can fire

employees, why can't employees fire bosses?" they ask.

But there are a lot of excellent options in between these two choices. For example, you can learn to accept your boss. "Some employees think they have a problem boss when all they have is a boss with a personality or operating style that's different from their own," caution the authors.

Another alternative is to "manage" your boss, defined as "giving bosses some of what they want and need, without compromising yourself or your integrity." This means examining your boss' strengths and weaknesses and helping him or her meet needs accordingly. For example, if your boss likes to appear really in charge when dignitaries are visiting, respectfully refer to him as "Mr. Brown" at those times. If he is disorganized, start doing small things on your own to help him.

You can also talk to the boss directly about the problem, go over his head or take a stand against him. These are risky strategies, but Grothe and Wylie suggest when it is appropriate to try them and how to do so effectively.

Problem Bosses is not really just for employees, however. If you are the boss, it offers you a chance to look at yourself through an employee's eyes and, if you are smart, improve your performance.

Quoteworthy

"It's my job to be the risk-taker and try new things. But the worst thing that can happen is I'll fail, and at this point, so what?"

Debbi Fields, founder, Mrs. Fields Cookies, quoted in the Miami Herald.

"The biggest little thing you can do is simply be nice to people .... And though it's a little thing, it pays off big and in unexpected ways. If you are nice to other people, they'll be nice to you. Not only will your business prosper, but your customers' return of courtesy will bolster your self-image."

Domino's Pizza founder Tom Monaghan in his book, Pizza Tiger *(Random House).*

For Your Tax File

By Gerald W. Padwe, C.P.A.

New Inventory Rules

Are you a manufacturer? A retailer or wholesaler? Are inventories significant to your business? If so, the 1986 tax law has targeted people like you for a significant contribution to our tax revenues.

First, the good news. If you are a small wholesaler or retailer (average annual receipts under $10 million), you are off the hook until you go over that amount.

For the rest of you, the news is all bad. A number of costs formerly deductible as normal current operating expenses will now have to be folded into the cost of purchased or manufactured inventory. Among them are all depreciation (including the excess of tax over book); all employee benefit plan expenses except those for past servicing of pensions; storage and warehouse costs; purchasing costs; and indirect support functions (payroll, personnel, data processing, legal, etc.).

These will be deductible only as inventory is sold. Associated costs for inventory left on hand at the end of any taxable year do not provide a tax benefit until the year that inventory is sold.

If you think this is only a one-year deferral of some deductions, and just to the extent that inventory is left on hand at year-end, you are correct. However, the magnitude of this deferral may be gauged from the revenue estimate attached to this particular part of the new law: According to last fall's report of the Senate-House conference committee on the new tax bill, $34.7 billion is expected to be raised over five years from this provision. It is one of the big ticket items in the 1986 Tax Reform Act.

Though the new rules affect only taxable years beginning after 1986, that does not mean you can wait until the end of 1987 to begin worrying about how they will affect you. In determining calendar 1987 or fiscal 1988 cost of goods sold (the category under which these capitalized amounts will now be deductible), an important component is the difference between opening and closing inventory. To make the two comparable, both opening and closing inventory must be stated using the same tax rules.

The significance of this is that your closing 1986 inventory is also your opening 1987 inventory. If, for example, yours is a calendar year business, you will have to determine your Dec. 31, 1986, inventory using the old tax rules for purposes of filing your 1986 return, and then redetermine that same inventory under the new rules to compute your opening 1987 inventory for this year's return.

In other words, now is the time to be thinking about the impact of these capitalization rules on your business. The further you get from the inventory date, the harder it may be to identify and measure the new costs. And, since the effect of the provisions is to increase opening 1987 inventory, additional income will have to be reported. The new law permits this increase to be taxed equally over a four-year period, so its determination should be as precise as possible.

The restatement of post-1986 beginning inventory under the new capitalization rules is complex enough for taxpayers using FIFO to value inventories. Last-in-first-out taxpayers are faced with the formidable task of revaluing their LIFO base year inventory (which may go back quite a number of years) as well as all layers added in subsequent years.

Fortunately, the Internal Revenue Service offers an elective procedure to average the impact of the new rules on the three most important years and then apply that to the LIFO base and layers. But even this elective approach will require significant effort.

The Prudent Bettor Wins

Last October, we reported on a Sixth Circuit U.S. Court of Appeals ruling overturning a U.S. Tax Court decision in an Internal Revenue Service case. The IRS had claimed $133,000 in additional tax from a corporation for use of an improper accounting method. At the same time, it had sought a $500 tax on the corporation's deduction of $1,100 of its controlling shareholders' personal expenses.

Holding that deduction of personal expenses on a corporate return had no reasonable tax basis, the IRS imposed a 5 percent negligence penalty on the corporation. Because a negligence penalty is applied to the *entire* deficiency, it amounted to more than $6,500 (about 5 percent of $133,000)—though the tax attributable to negligence was only $500.

When the Tax Court upheld the full negligence penalty, the Sixth Circuit reversed, calling the decision "absurd." As we said in October: "Since the statute does not grant exceptions for 'ab-

surd' cases, a prudent bettor (while applauding the Sixth Court decision) might give odds for the IRS."

There is a last chapter to this story, and in it the IRS gets the girl. The conference committee report on the 1986 tax law, discussing tax penalties, makes a specific reference to this Sixth Circuit decision and holds that it "inaccurately states present law." The language makes it clear that the negligence penalty will apply to the entire deficiency, no matter how absurd the result. Sorry about that.

Gerald W. Padwe is national director-tax practice for Touche Ross & Co. For Your Tax File *is an information service for readers. See tax and legal advisers on specific cases.*

It's Your Money

How can investors like you protect yourselves from the aftermath of the Wall Street scandal centering on arbitrageur Ivan Boesky (below)?

By Ray Brady

PHOTO: ROBERT A. CUMINS—BLACK STAR

Scary Times On Wall Street

Jim Rogers is one of the smartest men on Wall Street, and he is worried. Youthful, bow-tied Rogers made millions as a professional money manager. Now, from a lavish townhouse on Manhattan's Riverside Drive, he spends his time managing his own money—not other people's.

When Jim is worried about the stock market, the rest of us should be, too. Part of what concerns him is the Ivan Boesky affair's potential effect. As he notes, in 1973 the market was soaring. Then the Equity Funding scandal broke. Result: The market collapsed.

"There comes a time," Rogers says, speaking of market run-ups, "when something happens to cause people to stand back and look around. The Boesky thing may be one of those somethings."

When investors do what Rogers is talking about, they generally wind up selling stocks—and prices plummet. But the average investor, far from Wall Street, does not have ready access to information that many professionals get every day. How can he protect himself if the Boesky case does eventually bring a great shakeout in the stock market?

A. Gary Shilling, who runs a Wall Street economic consulting firm that bears his name, agrees with Rogers on the shakeout threat. As he points out, Boesky made illegal millions by getting inside information in advance on companies' plans to take over other companies—the eventual takeover move would push up the acquiree's stock, making profits for Boesky. Nervousness has now changed the takeover climate; some takeover plans have been canceled—or at least people think they have been. Says Shilling: "Weakness in stocks bid up by takeover expectations is possible, and it could turn into general market weakness."

Back to the question: What do you do if you are far from the scene of battle, but you want to protect yourself? I called scores of investment types for the answer, but the minute I said "Ivan Boesky," I could sense whoever was on the other end of the phone freezing up. Some would laugh nervously and repeat the latest Boesky joke. (Sample: "Do you know where Boesky is going to spend his vacation this year? At Club Fed.") Nearly all insisted on anonymity.

Here is a compilation of what these experts say:

One money manager advises that you follow his policy, which—even before Boesky—has been to avoid buying takeover stocks.

His reasoning: "If you see a company's earnings are rising, you know the rest of the market will spot that eventually, and the stock will rise. But if you buy stock of a company that you think could be taken over, you have no control over whether somebody will actually want to acquire its stock at a higher price than you've paid."

What if you wait until a bid for a company is announced, and then buy? Avoid that, too, the professionals advise. Case in point: Company A's stock is selling at $35 a share, and Company B offers $62. The price promptly goes to $58—not higher, because of (1) the cost of money borrowed to buy the stock while waiting for the merger to go through and (2) the risk that it won't go through.

"Often," says one professional, "the deal doesn't go through. Then the stock you've bought at $58 a share will drop to $35 a share. This is a game to leave to the arbitrageurs—don't play it yourself."

What worries other professionals: Companies sometimes paid for takeovers with junk bonds financed by the income from other junk bonds. Notes one analyst: "Many companies could only afford to pay 13 or 14 percent on a junk bond if they owned other bonds that gave them a high yield. So the underwriter would say, 'Why not invest in these three other junk bonds we're bringing out?'"

The fear is that if companies sell their junk bonds, that will spark a sell-off by others that could spread to the regular corporate bond market and then to the stock market. One money manager reports that he is 50 to 60

It's Your Money

percent in blue chip stocks and 15 percent in high quality corporate bonds; the rest of his funds' assets are in cash. "That," he says, "is the only way I can sleep nights until we can see where this thing is really going to end."

Gary Shilling has a scary notion of where it will end. He believes much of the consumer spending that has buoyed up the economy in recent months has come from investors who have fat gains on holdings. If the insider trading scandal spreads—as many think it will—those investors will pull in their horns and cut their spending, Shilling believes.

Result: The economy slows up. Shilling advises: "Avoid most tangible assets, and focus on quality bonds and on stocks that look like bonds, at least until after the next recession."

Grim words—but then, many analysts think the Boesky affair is the worst scandal to hit Wall Street since the early 1930s, when the head of the New York Stock Exchange was convicted of stealing from a fund for stockbrokers' widows and using the money to buy stock for himself.

Ray Brady is the business correspondent for CBS News.

To Your Health

A good exercise instructor can be as close as your own TV. Videocassettes offer an abundance of workout options.

By Marc Leepson

Running In Place—Your Own Place

Freezing rain is falling outside. The wind is vicious. You ask yourself: "How can I avoid the risk of getting pneumonia or breaking a leg on the ice and still get my daily exercise?"

What you can do is exercise at home, riding an indoor exercise cycle, lifting weights or using a rowing machine. Or you can get expert exercise instruction via videotape.

The large number of fitness videotapes available today allow you to exercise in the privacy of your own home at your own convenience, regardless of weather conditions. The best fitness videos provide safe, efficient exercise routines. Most are aimed at women and feature different types of aerobic dancing. But these routines are excellent, time-saving exercises for men, too.

"I get the same benefits from a tape as I do from an aerobics class," says Rudy Gillespie, who has an interior design business in Sacramento, Calif.

Finding a good fitness tape is not easy. A video exercise boom began shortly after actress Jane Fonda released "Jane Fonda's Workout" (Karl/Lorimar Home Video, 90 minutes) in March, 1982. Since then a cavalcade of celebrities—including Debbie Reynolds, Sid Caesar, Bruce Jenner, Irlene Mandrell and Raquel Welch—has come up with exercise tapes.

There also are scads of tapes by noncelebrity experts on everything from aerobics to thinning thighs and flattening tummies.

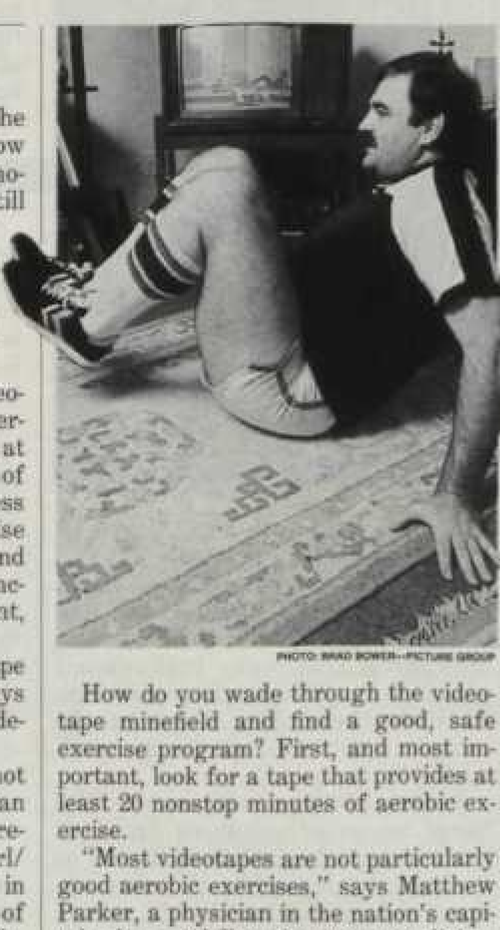


PHOTO: BRAD BOWER—PICTURE GROUP

How do you wade through the videotape minefield and find a good, safe exercise program? First, and most important, look for a tape that provides at least 20 nonstop minutes of aerobic exercise.

"Most videotapes are not particularly good aerobic exercises," says Matthew Parker, a physician in the nation's capital who specializes in sports medicine. "They have you move around a lot and exercise a variety of muscles. But the tapes are too short."

Most flattening and tightening tapes are "bogus," Dr. Parker contends. "The bottom line for most people is: If they want to get a flatter stomach or thinner thighs, they have to cut back on calories and lose weight. All the exercise in the world won't readjust fat."

It is also wise to preview an exercise video before buying it.

Here is a rundown on some of the best-selling tapes, which range in suggested retail price from $20 to $60:

- "Kathy Smith's Body Basics" (JCI Video, 60 minutes). This routine, designed primarily for beginners, passes all the tests. It contains a complete, safe exercise routine based on sensibly paced aerobics presented by a longtime aerobics instructor.
- "Jazzercise—The Best Yet" (Parade Video Cassette, 60 minutes). This workout conducted by Jazzercise founder Judi Sheppard Missett consists of a good warm-up, 25 minutes of aerobic dancing, and a cool-down period of floor exercises and stretching.
- "Total Beauty and Fitness" (Thorn/EMI, 108 minutes). Raquel Welch demonstrates 27 stretching poses. If you want to set aside a long block of time to do some serious stretching, this tape is for you. But it does not come close to providing total fitness.
- "Jane Fonda's Low Impact Aerobic Workout" (Karl-Lorimar Video, 50 minutes). For my money, this is the best of the Fonda tapes, of which there are now five, including one for pregnant women. "Low impact" aerobics, the latest aerobic dancing method, is done at a gentler pace with fewer jumping movements than conventional aerobic routines.
- "Do It Debbie's Way" (Video Associates, 85 minutes). Debbie Reynolds, who once danced her way through many movies, is still in good shape. In this tape she provides a decent routine at an easy pace.
- "Jacki Sorensen's Shape-Up" (MCA, 56 minutes). Sorensen, originator of the aerobic dancing concept, leads a no-nonsense, overall workout that pays close attention to getting your heart beating rapidly enough for aerobic benefit but also stresses safety.

Finally, a brief word on audiotape exercise programs. They are not as easy to follow as videos, but several worthwhile audiotapes are on the market, including audio versions of some videotapes. Among the better audio tapes is "20 Minute Workout for Couples" (Warner Audio).

Marc Leepson is a Woodbridge, Va., free-lance writer and the author of Executive Fitness *(McGraw-Hill, 1983).*

PEOPLE

Making It

Two tales of success, through sartorial excellence, equestrian style, and from banking on impressions.

Win, Place And Sew

Betsy Noble has turned her avocations—horses and sewing—into a winning combination. Her Custom Jockeys' Apparel in Hollywood, Fla., outfits jockeys and horses alike with colorful racing garb.

PHOTOS: LEN KAUFMAN

Betsy Noble feels as if she has won the daily double. Putting her money on her two favorite hobbies, sewing and horses, she has parlayed them into a thriving business—making racing silks.

Silks, the colorful jackets and cap covers worn by jockeys, are provided by horse owners to distinguish their animals from the competition.

Noble's company, Custom Jockeys' Apparel in Hollywood, Fla., got its start at her bedroom sewing machine in 1964.

"I was an exercise girl then at Hazel Park racetrack in Detroit and married to a jockey," says Noble, 44. "I would repair his breeches."

When a pair became too frayed, she made him new ones. Before long, jockeys admiring the fit and quality of Jerry Noble's breeches "wanted me to sew them new breeches." They also recommended her services to owners who needed silks.

In 1971 the Nobles moved from Detroit to the Miami area to be near the Calder, Hialeah and Gulfstream racetracks. Jerry Noble continued riding, and Betsy arose before dawn each day to solicit business at the tracks and to deliver orders. She still goes to the track each morning, but, she says, "I really don't want the business to grow much more. I'm busy enough."

Her rented 2,000-square-foot building is a riot of colorful bolts of fabric and threads. Nine employees work at the dozen sewing machines and cutting tables. Her husband, now 48 and retired from riding, helps operate an $18,000 computerized embroidery machine.

Besides silks, the company makes breeches, saddle towels (worn under the saddle) and blinkers (hoods placed on horses that block out vision to the side and rear). Betsy Noble's most colorful creations are the racing silks. The firm makes three or four sets a day.

Years ago they were actually made of silk. But since the advent of nylon in the World War II era, they have been made of nylon taffeta. The synthetic material is easier to clean, less expensive and wears longer than real silk.

The price of a set of silks averages $75. That price doubles, however, for owners wanting complicated patterns. "For example, one owner wanted a cornucopia, and it took me days to hand-sew the different colored grapes and grains," says Noble. Sometimes a customer has no pattern or colors in mind and asks Noble to create a design. Then she must refer to her own detailed files to ensure that she does not duplicate something done years ago.

Because of such customization, large manufacturers have backed off making racing silks. "Besides, no one could manufacture silks by the gross and maintain the quality we do," says Noble. Yet her firm used 15,000 yards of material last year.

Noble does have competitors, all businesses run by seamstresses like herself. Custom Jockeys' Apparel is the largest maker of racing wear, however, receiving orders year-round from some 40 racetracks worldwide. Sales in 1986 were $175,000.

Noble has yet to buy an ad, but she handles orders from as far away as South Africa and Hong Kong. Her "sales crew" consists of jockeys and racehorse owners who travel the international track circuit, mentioning her name to anyone needing racing attire.

Her customers include many top jockeys, including Willie Shoemaker, Chris McCarron and Laffit Pincay, and such prestigious thoroughbred operations as Calumet Farm. Recalls Noble, "I was making riding pants for Steve Cauthen before anyone heard of him."

She adds that, if she were a betting person, her profits might be even higher, because "invariably, when I make a new set of silks and a jockey wears them for the first time, he wins."

—*Del Marth*

Partners Lew Hoff (left center) and Alan Heffman have steered their Yonkers, N.Y., company, Bartizan Corporation, from financial disaster to prosperity, never veering from their belief in their product—a predominantly plastic credit card imprinter (bottom).

An Impression On Business

PHOTOS: WAYNE SORCE

"I was a sales manager for a company that went bankrupt in 1970. After everything was sold I looked across the empty office, and in one corner I saw a left-behind credit card imprinter."

Lew Hoff, 46, smiles at the memory. "For some reason I picked it up and took it home." After years of struggle, Hoff is glad he did.

Hoff's company, Bartizan Corporation, in Yonkers, N.Y., manufactures the machines that print your credit card data on sales slips.

Hoff and his current partner, Alan Heffman, grossed $5.5 million in sales last year, Hoff says. "That gives us about 35 percent of the credit card machine business."

But the tale begins some 13 years ago when Hoff began working with Ed O'Reilly. "O'Reilly had this idea," Hoff says, "that we could make imprinters quicker and for less money if we could figure out how to make the machine out of plastic instead of metal."

They formed a partnership and worked on the idea at night in Hoff's apartment. "I lived in a studio apartment," Hoff says. "And since O'Reilly was married, we'd get friends to come to my place to work in exchange for beer and pizza."

But the fledgling company was always running out of money. O'Reilly got in touch with an Army buddy, Alan Heffman, who sent the partners $9,300, no questions asked.

"That kept us afloat until we could start making some money, and Heffman became a partner," Hoff says. "We also had a supplier or two who had faith and who extended credit."

Hoff, then in his early 30s, began seeing his former classmates moving ahead in their chosen professions. Once he waited on the table of an acquaintance who was a successful attorney.

"Is this your real job?" the lawyer asked. Hoff remembers quite clearly the sudden sting of embarrassment when he had to answer "Yes . . . but I'm working on an idea."

After Hoff explained his idea, the acquaintance asked, "Could you sell these things to a bank?" Hoff's answer was "Yes" (banks provide the machines to merchants who honor bank cards), and the lawyer said he knew someone. He gave Hoff permission to use his name to try to make a sale. The bank ordered 50 machines.

But the partners' debts had grown to a formidable $100,000. O'Reilly wanted out. Hoff says: "I tried to convince him to stay just a little longer, but he was ready to go." Hoff and Heffman agreed to absolve O'Reilly of any debt liability in exchange for his interest in the company.

Later, after seeking the advice of a bank employee who was using their machines, the partners had an engineer friend design a metal base for the plastic imprinter. They sold 5,000 of the new metal-bottomed imprinters to the same bank. That was their first large sale.

Then the manager of Hoff's apartment house told him to quit cutting aluminum in the apartment or get out. So another friend arranged for work space in a Long Island barn. "They slaughtered pigs right next to where we were working," Hoff remembers.

That was the first of several moves, including one to a tumbledown factory building where Hoff slept in the back. He couldn't afford both an apartment and factory space.

For three years neither partner took a salary. Hoff continued to wait tables, and Heffman worked part-time as a movie projectionist.

Then, in 1983, after 10 determined years, Hoff and Heffman moved the factory to a 23,000-foot building where they now have more than 60 employees. Hoff says they simply outlasted their competition. "We started out bankrupt," he says, so the only way to go was up.

Hoff reports that banks are the largest group of Bartizan customers. Others include American Express, Diner's Club and K Mart.

When he looks back, Hoff admits, "If we had done things differently, we could have done well sooner. With more capital we could have hired people who had skills we lacked. But, being a New Englander, I just couldn't stand to go into debt."

The grandchild of Russian and Polish immigrants, Hoff says, "The business climate in the U.S.A. is encouraging, and all along the line people are willing to help out. I was fortunate to have been born in the right country."

Hoff and his new bride, Hannah, live in a pleasant Manhattan apartment now. "But sleeping in the factory paid off, just as I always knew it would."

—*Peggy Moss Fielding*

MANAGING YOUR BUSINESS

Direct Line

Information on copyrights, liability, food donation, children's wear, mail order and health insurance.

Protecting Art

How do I apply for copyrights on paintings, photography and other artwork?
F.S., Lihue, Hawaii

Copyrights are provided for the artist's lifetime plus 50 years. You must fill out an application form and enclose $10 along with a copy of your art. To get more information, request Information Package 115, Copyright Office, Library of Congress, Washington, D.C. 20559.

Nonprofit Liability

I have been invited to serve on the board of a local nonprofit community service organization. Unfortunately, the group has been having trouble getting liability insurance. If I accept the appointment, could I lose my business and personal assets if there is a lawsuit?
S.G., Burlington, Vt.

A dozen states have ruled that an unpaid officer of a nonprofit group is immune from liability. If the organization is found at fault, the plaintiff cannot reach beyond the assets of the organization itself. Unfortunately, Vermont volunteers do not have this protection. Federal legislation has been proposed to encourage more states to adopt this policy.

Distributing The Wealth

My company hosts many functions, complete with full-course meals. Because of overestimations and no-shows, the caterers end up throwing away hundreds of pounds of food every year. I hate to see so much nutrition go to waste. Any thoughts on how I might be able to put that food to good use?
J.S., St. Louis, Mo.

"Don't throw away anything that's edible; it can help feed the homeless and those on welfare," says Marcia Mellitz, executive director of Operation Food Search, a St. Louis food distribution service agency. "We distributed 20 million pounds of food—about $10 million retail value—in 1986. The bulk of it came from business donations."

The federal government has an enhanced deduction for this type of donation: Not only can you deduct the ex-

ILLUSTRATION: WILLIAM COULTER

pense of the food, but you can also deduct half of the profit you would have received had it been used as originally intended.

Mellitz says businesses have many opportunities to donate unused, edible food. Corporate cafeterias toss out leftover food daily, for example. Your business can donate food to services like Mellitz's that will give it to organizations in need. Or you can go to soup kitchens, shelters, churches and other direct service groups.

For more information about donating food in St. Louis or around the country, write Operation Food Search, 710 Hanley Industrial Court, St. Louis, Mo. 63144 or call (314) 644-5322.

Kids' Stuff

How can I get information on the children's wear industry?
M.A.J., Christopher, Ill.

Contact the United Infants and Children's Wear Association, 520 Eighth Avenue, New York, N.Y. 10018, or call (212) 244-2953.

Mail-Order Market

I am interested in starting a mail-order business for a home product. How do I go about marketing it?
P.P.G., Bronx, N.Y.

The first step is to identify your customer, says Ray Slyper, vice president of Muldoon Direct, Inc., a New York full-service direct mail agency. Is your customer male or female? How much money does your customer make? You should next decide whether you want to market the product in a magazine ad, in a catalog with other items you are offering or in a "solo mailing," a brochure in an envelope.

If you decide on the magazine route, Slyper recommends that you determine which magazines your customer is most likely to read. Before buying space, ask for the periodical's media kit to confirm that you are on target.

The catalog method is very expensive. You must have a wide selection of items and be prepared to pay $400 to $500 per 1,000 catalog copies printed and mailed.

Solo mailing is the cheapest method. Print up your brochures and ask a mailing list broker for a list of potential customers who fit your market profile. Slyper warns that you should not expect to make any money until after the third or fourth mailing.

Whatever marketing method you choose, be sure you have enough merchandise and can replenish stock in two weeks.

Health Insurance

What is a preferred provider organization?
J.O., Washington

A preferred provider organization, or PPO, arranges for health care provided by physicians and/or hospitals that are selected because of their ability to contain health costs. Health professionals who participate in PPOs provide medical attention at reduced rates and on a fee-for-service basis. For more information, see *What Employers Should Know About PPOs*, U.S. Chamber of Commerce Coalition Clearinghouse, 1615 H Street, N.W., Washington, D.C. 20062.

How To Ask

Have a business-related question?

Write to: Direct Line, *Nation's Business*, 1615 H Street, N.W., Washington, D.C. 20062. Writers will be identified only by initials and city. Questions may be edited for space. All replies must be given in this column.

THE NATION'S BUSINESS

Where I Stand

Results of this monthly poll on important public policy issues are forwarded to top government officials in the White House and Congress.

1. Sell U.S. Loans To Cut Deficits?

Under pressure from the Gramm-Rudman deficit reduction law, the administration proposes routine sales of federal loans (to students, farmers, home buyers, etc.) to private investors, producing quick revenue for the Treasury. Advocates say the desire to find buyers would make government lending more prudent. Critics grant that deficits would shrink in the short run but say they would swell in the long run because interest payments would be lost, and investors, who assume loan default risks, would pay less than face value. Should Congress approve sales of future government loans to cut deficits?

2. Remove Obstacles To Company Efficiency?

Critics contend that turn-of-the-century antitrust laws are at least partly to blame for many U.S. industries' loss of their competitive edge. Supporters of the laws say they promote domestic competition and protect the public from "predatory pricing" by monopolies. But opponents note that foreign competition, once negligible, confronts 70 percent of U.S. goods today, greatly reducing the threat of monopoly price gouging. They maintain that reforming the laws would increase business efficiency. Should Congress modify antitrust laws?

3. Tax The Affluent To Cut The Deficit?

House Speaker Jim Wright (D-Tex.) has proposed that Congress delay reducing the top income tax rate next year to 28 percent, as scheduled under tax reform, and indefinitely freeze it at the transitional 1987 level of 38.5 percent. He says the action is needed to cut the budget deficit. President Reagan opposes the delay, and Treasury Secretary James Baker says it would be "a general tax increase" that would break a congressional promise of revenue-neutrality for tax reform. Should Congress postpone cutting the top income tax rate?

Verdicts On December Poll

Here is how business owners and managers responded to the December issue's Where I Stand poll.

	Yes	No	Undecided
Should tighter safeguards for business secrets be enacted?	68%	22%	10%
Should Congress approve the proposed occupational hazard notification bill?	23%	72%	5%
Should teachers' salaries be raised as high as $72,000 and certification standards be made tougher?	30%	63%	7%

Send in your vote on the inserted postpaid card. Explanations of your views on any of these questions are also welcome as letters to the Editor, Nation's Business, 1615 H Street, N.W., Washington, D.C. 20062.

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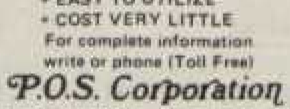

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The Treasure Of Her Company

When Lillian Katz goes shopping, she buys for many thousands. Her customers can pick from a global selection of knickknacks.

By Martha I. Finney

Lillian Katz is in her office today because she is not in China. She is not in China because she broke her ankle. She is also in her office—wearing high heels that are perilous for someone at her stage of recovery—because her doctor did not reckon with his patient's personality.

"The doctor took the cast off two weeks ahead of schedule because her ankle is mending quickly," says her secretary, Geri Harty. "Knowing how Lillian is, he should have kept the cast on four more weeks, just to keep her from trying to do too much."

Katz says the pain is distracting, but there is no trace of a limp as she gets to the wheelchair behind her desk.

Casual catalog shoppers may not know Lillian Katz—but they probably know her Lillian Vernon Corporation. Katz's $137-million-sales company, which she named after herself and its hometown, Mt. Vernon, N.Y., collects and sells colorful knickknacks made of plastic, cotton, glass, wood or porcelain. Mainly, the company markets nifty solutions to problems so trivial that you may have given them little thought before looking through its catalog.

Tired of those pesky notepads that bulk up your briefcase? Buy a personalized black leather jotter, "fine executive gift," $8.98. Have paperbacks coming out of your ears? Try the handy book rack that hangs on a door, $7.98. A Lucite rack organizes your food processor blades and discs, $19.98. The triple magnifying mirror helps myopes put on makeup, $12.98.

Then there are the frothier items, aimed more squarely at gift-givers: stained glass windows, baskets, umbrellas with duck-head handles, even red and green Italian toothbrushes with a Christmas tree motif. And there are monogrammed gifts. You can celebrate a couple's first Christmas with a tree ornament with their name engraved on the attached plaque. Door knockers, lint brushes, contact lens cases, pencils and terry cloth bathrobes can all be monogrammed.

This is how Katz got her start. She made her name in other people's initials.

"Monogrammed items make such nice gifts," she says. "You simply can't rush out to a store and buy a present

Lillian Katz started the Lillian Vernon mail-order company to bring in $50 a week. It has brought in millions.

PHOTOS: LILLIAN VERNON CORPORATION

that's instantly monogrammed. It takes planning and thought. That makes the gift all the more special to the recipient. No one can start a mail-order business today the way I did in 1951, but if I had to start over now, I'd definitely begin with monogrammed merchandise again."

The daughter of a Jewish industrialist, she was born Lillian Menasche in Leipzig, Germany, in 1927. Her family fled to Holland in the mid-1930s, then to Manhattan in 1937—presumably to keep her brother from fighting in a war that was clearly on the way. "As far as I know, we had no inkling that we were all in danger," she says. "I just thought we were protecting Fred. He died anyway—fighting on the American side."

The Americanization of little Lillian did not take long. Soon she was devouring *True Confessions* magazine with her young friend, Hannah Mayer, who recently wrote her a letter: "I've been a Lillian Vernon customer since 1968. Could you be the Lili who went to Joan of Arc Junior High and lived on Amsterdam Avenue?" Her father also plunged into his new American life by making reconditioned zippers (zipper manufacturer Talon was busy outfitting the war). At war's end, he began making leather goods—first camera cases, then handbags and belts.

He had the necessary merchandise in stock when 24-year-old Katz wanted to add $50 to her husband's weekly income of $75. Pregnant with their first son, whom they named after her brother, Katz took $2,000 of wedding-gift money, bought some supplies and dropped $500 into a *Seventeen* magazine ad for personalized handbags and belts. "Be the first to sport that personalized look," read the ad for purses ($2.99) and belts ($1.99).

Katz's relatively modest motivation of supplementing her husband's income did not foreshadow how those early years would affect the rest of her life.

"I figured that for $125 a week we could do everything we wanted to do," she says. "I liked the stimulation of work, and I wasn't prepared to do only child care. I chose the mail-order business simply because it was the only thing I could think of that would allow me to work at home and be with my children.

"Many people tried to talk me out of the business. Sam Hochberg, my first husband, treated it like a hobby. I felt it was very important to me because it was mine, and it gave me a wonderful sense of independence."

Within six weeks of the first ad, Katz was at her kitchen table sorting through $16,000 worth of orders. That first taste of success brought out a driven side to her personality that no one expected to see.

"When we first were married, she took a clerical job," says Hochberg. "She never showed any drive or ambition. Never before had she felt she had it in her to run a business."

Hochberg says differences in work philosophy eventually ended their marriage in 1969. "I'm more the playboy at heart, while she's the hard worker," he says. "I just wanted to earn enough money to live the good life. I would have retired 25 years ago, if I could have afforded it." When they divorced, Katz got the mail-order business.

Thirty-five years later, Lillian Katz,

The Treasure of Her Company

Lillian Katz finds most of her merchandise on trips to Europe and the Orient (she is in China at left). Her 850-item catalog contains products that are both practical and fun, like (clockwise from top left) duck candles, pet food dishes, a pulse monitor and plastic toys.

now married to display fixture manufacturer Robert Katz, has spread her U.S. operations from Mt. Vernon throughout the bedroom communities of New York City, with distribution warehouses in Port Chester, Elmsford and New Rochelle, N.Y. New Rochelle is also the location of her high tech communications center. For a company that receives 30,000 telephone orders weekly, the center is surprisingly quiet—not a ringing telephone anywhere. Operators listen and speak through headsets as they key in orders on computer terminals.

To keep her 1,000-employee company running smoothly, Katz attracts good workers by subsidizing bus service for commuters from the Bronx and offers recruiting incentives for her staff. An employee who brings in a new worker gets $25 if he or she stays 60 working days. Still on the payroll after 90 days? The recruiter gets another $25.

In addition to a manufacturing plant in Providence, which makes the company's brass items, Katz has buying offices in Italy and Hong Kong. Of the 850 items in each of her 10 yearly catalogs, 55 to 60 percent are imported. She would do more business with American manufacturers, she says, if they were as accommodating as foreign manufacturers in handling her requests. She says the foreigners are more likely than Americans to adjust the color on this coffee mug and produce more of that flannel sheet, for instance.

"I want the American manufacturers to become a little more creative and to really get out there and fight," she says. "I don't think they're aggressive enough to go out for the business. They should; they'd get it."

Her first overseas excursion was to the Frankfurt trade show, where manufacturers from all over the world brought merchandise. It was her first trip to Germany since she left it as a child. "I broke out in a rash," she says. "I don't harbor the same hatred toward Germans that some other people do. I now have many German suppliers. But I won't go back to Leipzig out of respect for my father."

Katz's buying style is quick and decisive, both in terms of quality and price. "We are tough negotiators," she says. "We either go away with the money in our pockets, or the manufacturer goes away with it in his pocket. I might as well go away with it in mine. But the product is most important. If I see what I want, I just go for it. I want it, I buy it; I don't give up until I have it. It's good for the company."

Also good for the company is Katz's intuition about good employees. Take Ray Slyper. With little more than a high school diploma and a few years' experience at another mail-order company, she was hired to help with mailing list rentals. Katz soon felt that Slyper was capable of managing the company's mailing list operations. Slyper thought she was not, without the aid of outside list brokers. When she finally gave in, and mailing list management was brought totally in-house, under her, Lillian Vernon's sales doubled in one year. A few years later, Slyper was made a vice president.

Recently, after more than 13 years with Lillian Vernon, Slyper became vice president of another New York mail-order firm.

"Lillian knew a lot better than I knew what I was capable of doing," says Slyper. "She was a terrific role model for me. I took away with me a management style that includes a sense of fairness and of the rewards of developing the people who are working for me."

One aspect of Katz's management style that gives some people pause is her temper.

Asked about it, she says, "Why is it so terrible that I get mad once in a while? The buck stops with me and, well, sometimes the buck gets very hot. It's O.K. for a man to lose his temper; it's not O.K. for a woman?

"I'm honest. I'm loyal. I'm a good friend. I don't drink. I don't walk up Fifth Avenue without my clothes on. Is temper all they have to find fault with me on? Fine."

In 35 years of building a business from a kitchen table to offices scattered on three continents, Katz has made her share of mistakes. And she has one regret. Perhaps she should have torn a page from Hochberg's book, after all.

"I wish I had taken more vacations," she says. "If I had two weeks, four weeks, even six weeks off each year, my business still would be here." Even as she speaks, she is on the job—in that wheelchair. NB

COMMENTARY

Congressional Alert

Here, in brief, are important legislative issues along with suggestions from *Nation's Business* on what you should tell members of Congress about them. Addresses: U.S. Senate, Washington, D.C. 20510 and U.S. House of Representatives, Washington, D.C. 20515.

ISSUE	BUSINESS IMPACT	BUSINESS MESSAGE
Budget	Steps that Congress can take to meet deficit reduction targets of the Gramm-Rudman-Hollings law include privatization—turning over appropriate federal government activities to taxpaying businesses. Such businesses can usually provide goods or services more economically than federal agencies. Stepped-up privatization would contribute to reaching the $108 billion deficit target set for fiscal 1988.	Members of the House and Senate: Maintain the Gramm-Rudman-Hollings deficit reduction targets, which climax with a balanced federal budget by fiscal 1991. Support efforts to privatize numerous activities now being performed by the government. Privatization is an effective approach to reducing federal spending and one step in reaching a balanced budget.
Tax Rates	The recently enacted low marginal income tax rates—15 percent and 28 percent for individuals (plus a 5 percent surcharge at certain high income levels) and a top rate of 34 percent for corporations—must be retained. Raising tax rates would undermine any positive economic impact from tax reform.	Members of the House and Senate: Oppose efforts to raise tax rates. Oppose any further reduction or elimination of deductions and credits unless matched dollar-for-dollar by further reductions in tax rates.
Minimum Wage	Increasing the federal minimum wage artificially raises the cost of producing goods and providing services. In addition, a high minimum wage denies jobs to many of the nation's least skilled workers, particularly teenagers.	Members of the House and Senate: Oppose any increase in the federal minimum wage. An increase would add to the cost of products and services and reduce entry-level job opportunities, further hurting individuals in the highest unemployment categories.
Plant Closing	Companies could be forced to continue operations at money-losing plants if Congress enacts legislation requiring notice to, and consultation with, affected workers before such plants are closed. The consultation process could cover alternatives and modifications to decisions involving plant closings, layoffs or reductions in hours.	Members of the House and Senate: Oppose plant closing legislation. Passage would create a great potential for abuse by organized labor. Unions would have every incentive to use delaying tactics to keep employers from implementing decisions dictated by economic necessity. Managers must be free to make basic decisions affecting their businesses.
Polygraphs	Congress may pass legislation to prohibit private sector use of the polygraph. The polygraph is an essential tool for employers, not only for pre-employment screening but also for investigating workplace incidents. It helps businesses to control costs.	Members of the House and Senate: Oppose legislation banning use of the polygraph by the private sector. Support action in the states to license examiners, issue guidelines for administering examinations and regulate the polygraph industry to help ensure responsible use of this important tool.
Occupational Hazard Notification	Legislation before Congress would create a massive, duplicative bureaucracy. A new agency would administer a program to identify occupational hazards and notify and counsel workers regarding their medical conditions and legal rights. An expensive federal program, recently implemented, already addresses worker notification.	Members of the House and Senate: Oppose occupational hazard notification legislation. Do not add to the excessive regulation, litigation and employer expenses that result from current federal requirements. Do not create another unneeded bureaucracy. Oppose moves like this that could be a step toward federally mandated health benefits and federalized workers' compensation.

COMMENTARY

Editorials

"The notion that government spending, in and of itself, may be destructive to economic prosperity has never been adequately challenged."

A New Issue For Congress To Consider: "The Morality Of Government Spending"

This year the federal government enters an era of trillion-dollar annual operating budgets. Federal spending for the current fiscal year now is estimated at $1,015,600,000,000 and for the fiscal year beginning next October 1 at $1,024,300,000,000.

The advent of 13-digit budgets can be placed in historical perspective by pointing out that $1 trillion represents the total of all annual federal budgets between 1789, the first year of the republic, and 1955. The government thus will spend in this year alone as much as it spent in the first 166 years of its existence.

Granted, the nation's size, population and global responsibilities have increased by many magnitudes since its early days. So has the economy that supports government expenditures. And the needs and demands of our society have grown more complex, even since 1955.

It is nevertheless appropriate to question whether those factors fully justify the acceleration in federal spending over the last two decades. The federal budget stood at $157 billion in 1967, reached $409 billion in 1977 and, as noted, will be $1 trillion for 1987. Most of that increase has been in open-ended social programs.

Despite all the allegations that the military budget has skyrocketed at the expense of the unfortunate, defense spending today takes a much smaller percentage of federal outlays than it did 20 years ago.

Nevertheless, much of the forthcoming debate over the fiscal 1988 budget that President Reagan has submitted to Congress will focus on claims that federal spending must be increased to ensure economic prosperity for all. Poverty, unemployment and a wide range of other social problems can be cured, it will be argued, with sufficient federal outlays.

Those arguing against that proposition will be assailed as heartless and uncaring.

But an increasing body of economic

research shows that those who favor spending restraint are doing far more to bring about prosperity for all than those who cannot see any answer beyond greater outlays by the federal treasury.

Richard W. Rahn, vice president and chief economist of the U.S. Chamber of Commerce, says the issue should be framed in terms of "the morality of government spending."

"The notion that government spending, in and of itself, may be destructive to economic prosperity has never been adequately challenged," he says.

Rahn points to rapidly growing evidence that, "beyond a certain point, increases in government spending (as a percentage of gross national product) become an economic hindrance—additional spending is more likely to increase economic misery than to alleviate it."

That happens, Rahn continues, as government spending takes an increasingly larger share of the economy's resources but uses those resources in a manner that does not contribute to economic growth.

"At even higher levels of government spending," Rahn says, "the public sector may actually have a negative impact on the economy by providing perverse incentives. For instance, many well-meaning social programs, largely those associated with income transfers and cash assistance, have such adverse effects on savings and labor supply that they discourage productive activity.

"Thus, their expansion would reduce, not increase, long-run economic growth."

The tax impact of excessive government spending must also be considered. Rahn says, "The combination of high levels of government spending and the associated high tax burdens necessary to finance that spending are a powerful disincentive to productive economic activity."

He cites the experience of the seven major industrialized nations, where the combined gross domestic product growth rate has fallen steadily since 1965 as government spending as a percentage of GDP has steadily risen.

Basically, the economist says, "a modest reduction in government spending will not cause a recession but will enhance economic growth by reducing the government's claim on productive economic activity."

He recommends that provision be made for a transition period to minimize undue hardship on those affected by cutbacks in federal spending, but says:

"If a member of Congress is going to act as an economically responsible and moral individual, he or she must work to reduce aggregate government spending and to eliminate or modify those spending programs that cause more total misery than benefits."

Those members of Congress who profess concern about providing economic opportunities for the unfortunate should take a hard look at "the morality of government spending" before they join the debate on federal spending priorities.

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